

Global Insight

Perspectives from the Global Portfolio Advisory Committee




European economy: Course correction?

European economic growth has veered off track; can the economy regain its long-term growth trajectory?

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Global equity
Higher ground ahead ...
and higher risk



Global fixed income
Things that go bump in
the night—deliver us!



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The “countdown clock” for the next U.S. recession has not yet started, but it is closer to doing so. The odds are good that stock markets will post new highs in the year ahead. There is also a growing probability that a cycle peak for markets will be set sometime within the same interval.

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We think the stage is once again being set for monetary policy convergence led by the Fed. But this time it could be a move toward easy street, or at least easing off the brake.

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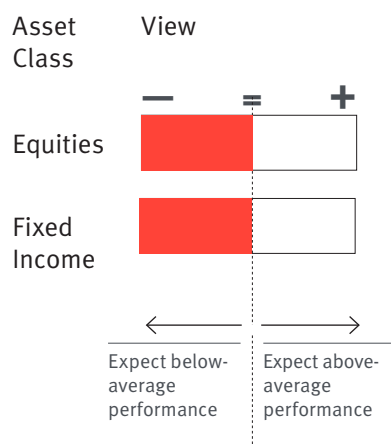
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All values in U.S. dollars and priced as of market close, February 28, 2019, unless otherwise stated.

RBC's investment stance

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See “Views explanation” below for details

Source - RBC Wealth Management

Equities

- Equity markets have rallied very strongly since their December lows. With many of them now in overbought territory, we would expect them to trade within a range in the short term—in fact, it wouldn't be unusual for them to retrace some of their gains.
- After this period of consolidation, we continue to anticipate major markets can reach new highs within the next 12 months or so. The U.S. economy is still growing, if slowing down somewhat; headwinds in Europe are diminishing; and a potential trade agreement between the U.S. and China seems within reach. Moreover, most markets are trading at or below their longer-term average price-to-earnings multiples. We are Market Weight in all regions, except in Japan where we are Overweight as valuations are particularly attractive.

Fixed income

- The Fed's recent dovish pivot shows signs of spilling over into other central banks' monetary policy plans as a global economic slowdown takes hold. In January, Fed policymakers exhibited a willingness to wind down their current balance sheet run-off by year-end, which should alleviate the “quantitative tightening” fears so prevalent at the end of 2018.
- The present environment is one where we believe rates have limited room to move higher and there is a possibility the Fed's next move could be a rate cut. We believe this makes the case for adding some duration to portfolios. Given late-cycle concerns and the recent rally in riskier asset classes, we maintain a Market Weight in fixed income with a focus on selective opportunities in quality assets.

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.

European economy: Course correction?



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Is the European economic cycle fizzling out, or will it reassert itself? We look at what has caused Europe to veer off track and make the case that the economy will regain its long-term growth trajectory. Investors should take short-term concerns in stride and seek out globally focused, quality companies unfazed by cyclical setbacks. Europe is home to most of the prestigious global luxury goods brands, as well as market leaders in pharmaceuticals, heavy industries, and chemicals—all of which have withstood the test of time.

Surprisingly slow

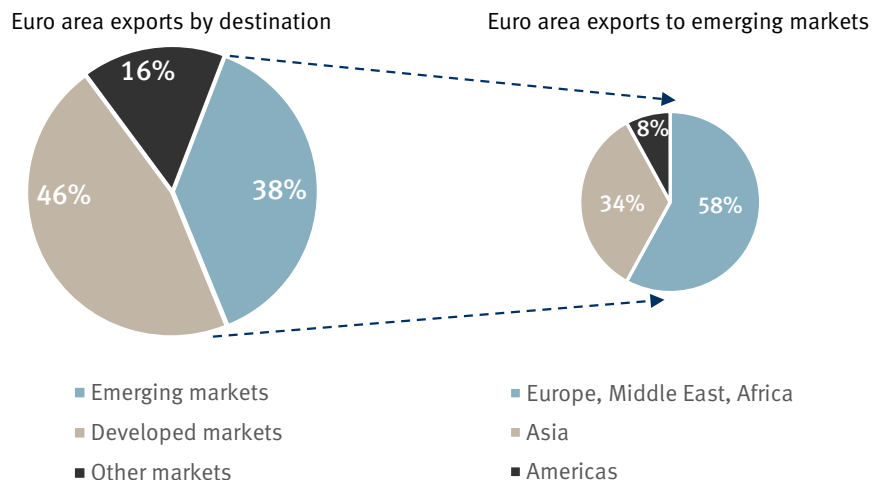
The extent of the European economy’s slowdown took observers by surprise in 2018. Quarterly GDP growth ground down to a meagre 0.2% in Q4 2018, after consistently posting quarterly growth of around 0.7% in 2017. While slowing global trade was the main culprit, an outburst of political risk and unfortunate one-offs exacerbated the situation.

In contrast to the U.S., Europe is a much more cyclical economy which depends heavily on external demand. Exports of goods and services represent 28% of GDP for the eurozone versus only 12% for the U.S.

The eurozone is also unusually exposed to emerging markets. RBC Capital Markets points out that the region sends some 40% of its exports to emerging economies, mostly on its doorstep in emerging Europe, but also to Asia, half of which goes to

Emerging Europe and Asia are key export destinations

Euro area export destination breakdown, % total exports



Source - Haver Analytics, RBC Capital Markets

China. The fall in euro area export growth was largely due to declining demand from Asia, though emerging economies closer to home (Poland, Turkey, and Russia) also played a role.

In addition, political risk flared up in Italy and France. In Italy, the inexperienced/ radical government's acrimonious budget negotiations with Brussels pushed Italian bond yields sharply higher, discouraging lending and investment. While it eventually agreed to EU demands to rein in spending and restrain the ballooning national debt, the damage was done. Italy slipped into a technical recession, with the economy shrinking by 0.1% in Q3 and by 0.2% in Q4. In France, the "Yellow Vest" protests against reforms dented domestic economic activity.

Meanwhile, Germany was affected by temporary factors such as new auto emissions testing standards, which drove car and car part output down by 8%. This shaved close to 0.4% from German GDP in Q3 as auto manufacturers postponed production of models not yet certified under the new regulations. Finally, a drought left water levels in the Rhine, a much used transport waterway for heavy industries, perilously low, preventing barges from operating at full capacity.

Many dynamics point to the possible emergence of a cyclical upswing later this year.

Recovery rudders

With the impact of some of these factors still being felt, the 10-year German Bund yield fell below 0.1% in early February, suggesting a very subdued outlook for economic growth. Could the slowdown morph into something more sinister?

Many dynamics, however, point to the possible emergence of a cyclical upswing later this year, enabling the eurozone to get back to its trend growth of some 1.5% per annum. Trade is showing signs of stabilising and some of the aforementioned transitory problems are beginning to recede. Car certifications are starting to be issued in Germany, enabling manufacturers to meet the pent-up demand, while the Yellow Vest protests in France look likely to dissipate further, if not disappear altogether.

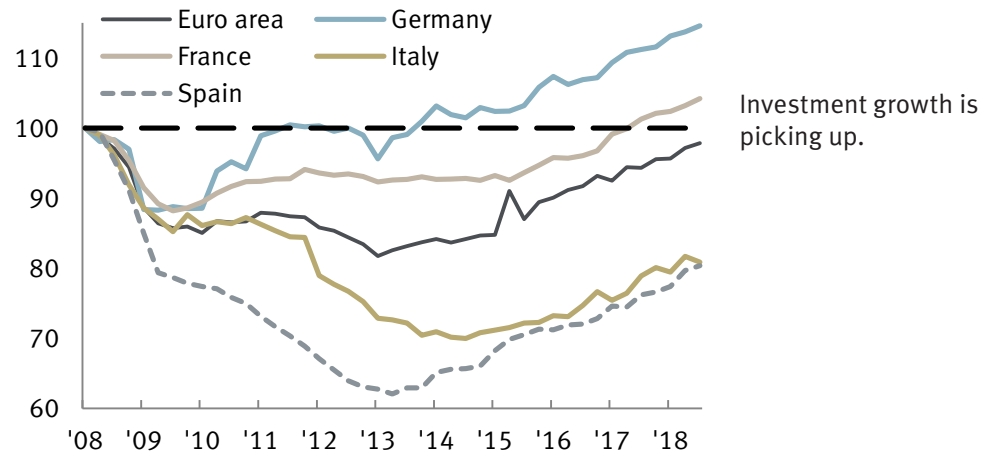
In France, President Emmanuel Macron has refocused his agenda towards domestic policies. His party's majority in Parliament suggests he can govern for his full 5-year term. Public finances are in good enough shape for the government to stimulate the economy in an attempt to appease protests. It's worth remembering that past reformers, such as the U.K.'s Margaret Thatcher and Germany's Gerhard Schroeder, faced notable resistance before transforming their economies. The risk, in our view, is that Macron bows to protest pressure and considerably waters down the pro-growth reforms.

Importantly, Europe does not display any imbalances or excesses that would need to unravel. RBC Capital Markets points out that household debt-to-income ratios, already low, are on the whole falling, suggesting consumers are financing spending from rising incomes rather than new debt.

Moreover, fiscal policy is set to be less of a drag on growth, as much of the heavy lifting to put national finances on a healthier path after the financial crisis has been completed. Budget deficits of all 19 euro area member states should hover around 3% in 2019. As such, France, Spain, Italy, and Germany are modestly easing fiscal policy.

Unemployment is at cyclical low of 7.9%, with some one million jobs created in 2018, according to RBC Capital Markets, despite slow growth. Wages are climbing and inflation is topping off; both bode well for households' real incomes. Banks' lending to the private sector continues to gradually strengthen at a time when capacity utilisation is at a multiyear high.

Investment across main euro area economies



Source - Haver Analytics, RBC Capital Markets; data through July 2018

Finally, the European Central Bank (ECB) has acknowledged the weakened economic backdrop, and RBC Capital Markets expects it to consider a new round of targeted longer-term refinancing operations (TLTRO), an inexpensive loan scheme for European banks, at its March meeting. Market expectations of a first rate hike have been pushed back to early 2020.

Several risks could derail this benign scenario. The U.S.-China trade war could boil over and a destabilising “no-deal” Brexit is a possibility, but both of these are unlikely to materialise, in our view. More concerning is a potential end of the U.S.-EU trade truce. A U.S. Department of Commerce report recently concluded EU car and car part imports pose a risk to U.S. national security. U.S. President Donald Trump could threaten the EU with 25% car import tariffs. Beyond the noise, with both sides having much to lose from a growing conflict and with not much appetite in the U.S. for a trade war with the EU, unlike the case against China, we would expect these tensions to eventually ease. Finally, looking at the long term, Italy remains the eurozone's weakest link. The country may well muddle through until the next European recession, but further reforms are imperative, in our view.

Will politics play the spoiler?

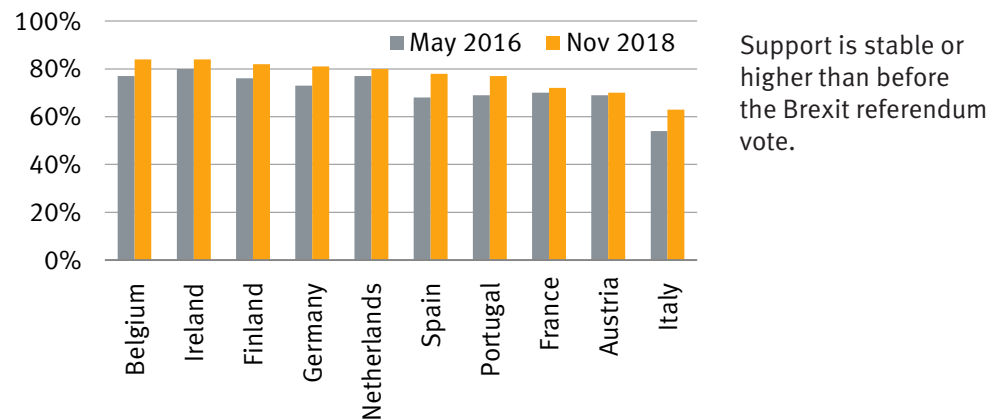
It is noteworthy that public support for the euro across the continent has increased over the past two years, probably thanks to soul-searching caused by the Brexit saga and to the trade war-induced unravelling of the established world order.

This growing support may make it more difficult for euroskeptic parties to make real inroads at the upcoming European Parliament elections in May. Beyond selecting members to the Parliament, these elections will also eventually put new

faces in the EU's top jobs, such as for the presidents of the European Commission, the ECB, the European Council, and the European Parliament.

Regardless of the outcome, changes at the top do not necessarily mean a shift in policies. EU decisions are made by the European Parliament *in conjunction* with the European Council, itself made up of national leaders who are mostly pro-EU. Compared to the U.S. or China where one personality sets the tone for an entire political cycle, changes at the helm of the EU are less important, given it is a slow-moving organisation where major decisions require near consensus. If anything, more support for the EU may herald more cooperation in the reform effort.

Percentage of citizens supportive of the euro



Source - Eurobarometer semi-annual surveys; RBC Wealth Management

Europe has a vast array of long-established companies with a long, successful history of growing amid difficult environments.

The way forward

We maintain our Market Weight exposure to European equities. A more bullish stance would require the prospect of earnings upgrades. But those are difficult to see with consensus earnings growth for 2019 already penciled in to be a generous 8% y/y, up from an estimated 6% for full-year 2018. With Q4 2018 earnings growth so far only in mid-single digits, a much steeper upswing in both the domestic and global economic background would be necessary to achieve current consensus 2019 estimates, in our view.

Despite potential earnings downgrades, valuations are not very demanding on 2019E and 2020E price-to-earnings multiples of 13.1x and 12.0x, respectively. On a 12-month forward basis, European stocks trade at a 15% discount to U.S. stocks, adjusted for sector weight differences.

We retain a bias to quality companies, particularly to exporters. Europe has a vast array of long-established companies with prestigious global brands, and a long, successful history of growing amid difficult environments. We find value in Health Care, Industrials that benefit from secular trends such as urbanisation and digitisation, and consumer-focused companies with leading market positions and strong brands.

Higher ground ahead ... and higher risk

When we look at stock market averages in the developed economies, we find most are currently trading at or near the levels that prevailed two years ago in the first half of 2017. The S&P 500 and Canada's S&P/TSX are somewhat above that zone but still below their all-time highs posted last summer. What have changed more substantially are valuations and expectations.

Using the S&P 500 as an example, back in mid-2017 the index was trading at a rich 19x trailing earnings. But investors weren't put off because one-year forward earnings estimates were rising at a brisk 10% and they would go on rising at that rate right through to mid-2018. The resulting forward price-to-earnings (P/E) multiple was a more palatable 17.4x.

Moreover, those earnings estimates looked solid, and proved to be, because a significant part of the improvement was reliably coming from the newly arrived lower U.S. corporate tax rate and because management forward guidance was confidently optimistic.

Contrast that with today: forward earnings estimates for this year are falling, not rising, all the way from \$179 per share down to \$168 (we remain at \$171). This has left the trailing 12-month and forward P/E multiples at a much more subdued 17.1x and 16.6x, respectively.

Today's diminishing earnings expectations are being shaped by the widespread view that the longest of all U.S. economic expansions is in its final stages. RBC Global Asset Management

Equity views

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

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

Chief Economist Eric Lascelles rates 17 different variables as to which phase of the economic cycle—early, mid-, late, end of cycle, or recession—each is currently in. Today, fully 14 are either in the late- or end-of-cycle categories.

That said, even as the early- and mid-cycle phases of the expansion both lasted for an extended period, the end-of-cycle phase could prove to be drawn-out too—all the more so, given that every major central bank has indicated they are in no hurry to raise rates from here. The People's Bank of China, for its part, has been easing aggressively.

Since it is our view that the U.S. economic cycle largely determines the rhythm of the global cycle, we are focused on targeting the likely onset of the next U.S. recession well ahead of time. Of several reliable leading indicators of recession, so far none has definitively reached a level that would say a recession is on the way. However, two of these that have typically given the longest lead time ahead of a recession's start date—the gap between

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short-term and long-term interest rates and the trend in unemployment insurance claims—are both within striking distance of giving such a signal.

The reassuring news is that even once such a signal is given the ensuing recession is typically a year or more away from starting. Less comfortable is the fact the stock market usually peaks before a recession begins.

We have been impressed by the power of the markets' liftoff from the depressed December correction lows. Some measures of market breadth have reached new highs ahead of the averages. Sometime over the next months or quarters we expect most broad market averages will reach new high ground as well. If, by that time, our leading indicators are signaling a U.S. recession is on the way, then we expect to counsel using that strength to adopt a more defensive stance toward global equities.

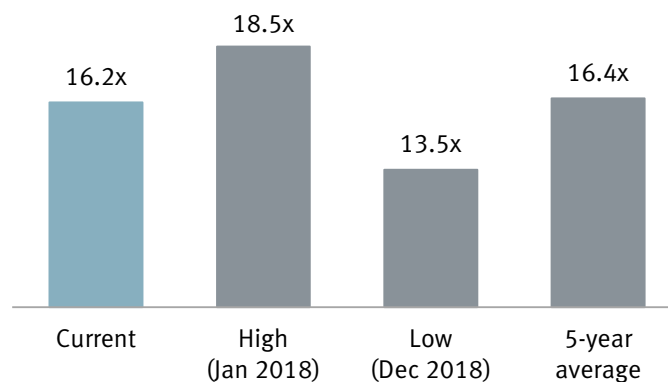
Until such signals arrive our recommended stance is what it has been for the better part of nine years: give equities the benefit of the doubt.

Regional highlights

United States

- U.S. equities continued to march higher in February with the S&P 500 rising 3.0% on improved prospects for a trade deal with China, as the global economy showed signs of stabilization and the Fed reasserted it will hold off raising interest rates for now. While the rally has been broad-based, small-cap stocks have outshone large-caps since the December low, surging 24.4% versus 18.4%, respectively.
- Better-than-feared earnings momentum also fueled the market. S&P 500 earnings growth for Q4 2018 will likely finish around 16.7% y/y, with almost half of that attributable to the boost from corporate tax cuts. The full-year 2019 consensus forecast is for 4% growth (no tax-cut boost this year), or \$168 per share. That forecast has come down meaningfully from a peak of \$179, and we think it is now too low. RBC Capital Markets maintains its \$171 estimate.
- Although 2018's 20%+ growth in earnings makes year-over-year

S&P 500 forward price-to-earnings (P/E) ratio



With the return of volatility, market valuations hit 5-year highs and lows in 2018. Since the Christmas Eve low, the S&P 500 has rallied to a near-normal level.

Note: P/E ratio based on next-twelve-month EPS estimates
Source - RBC Wealth Management, FactSet; data through 2/28/19

comparisons difficult, an issue compounded by slowing GDP growth in 2019, we are still constructive on the market and believe valuations remain reasonable. But the market has come so far so fast lately that it would not be unusual to encounter a cooling-off period, or even a partial surrender of the year-to-date gains. Regardless, the domestic economy seems sturdy enough to ultimately drive the major indexes to new highs. We would maintain a Market Weight position in U.S. equities.

Canada

- We maintain a Market Weight recommendation with respect to Canadian equities. Domestic-specific challenges (e.g., household leverage, energy market access, and economic competitiveness) are widely discussed and, we believe, appropriately reflected in the Canadian equity market's valuation.
- The Canadian market has started the new year on a positive note with a year-to-date gain of 11.7%, comparing favourably to global benchmarks. Health Care (led by cannabis stocks) and Technology have been the best-performing sectors, but it is the strong returns of heavyweight components Financials and Energy that are truly driving benchmark returns. With the Canadian market's 2019 performance roughly in line with that of the S&P 500, the domestic benchmark continues to trade at a historically wide valuation discount to the U.S. market.
- The Canadian oil sands industry is set to see another foreign player make its exit after a U.S. producer announced the initiation of a process

to sell its Canadian assets. Market access deficiencies and the resulting discounts for Canadian crude oil have served as stiff headwinds to attracting corporate and equity investor capital alike. Alberta production curtailments will relieve Canadian oil discounts in the short term, with the medium-term outlook still mired in uncertainty as the Line 3 Replacement seeks to secure key permits in Minnesota and the Trans Mountain expansion faces continued resistance from environmental groups and certain First Nations indigenous peoples.

Continental Europe & U.K.

- We are Market Weight U.K. equities. Though Brexit negotiations have entered the final stage with less than a month before the exit date of March 29, there is still little clarity as to what sort of withdrawal it will be. Whilst delays are increasingly possible given the government's and businesses' lack of preparation for Brexit, we continue to expect that Prime Minister Theresa May's Withdrawal Agreement will eventually go through in some form, thereby enabling the U.K. to benefit from a transition period. Low valuations of U.K. equities suggest to us that some uncertainty is already discounted in the market.
- We continue to prefer companies that generate a large proportion of their revenues abroad, in particular favouring Energy and Health Care.
- May is under increasing pressure to rule out a "no-deal" outcome, i.e., crashing out of the EU without a transition period. Should she bow to such pressure or should the House of Commons take the reins of Brexit

negotiations from her, we would expect the pound to strengthen, which would likely cap the gains of the overall equity index. Under this scenario, we would increase exposure to some domestic-orientated sectors that offer good value, such as Financials.

- We are Market Weight European equities; please see [“European economy: Course correction?”](#) on page 4.

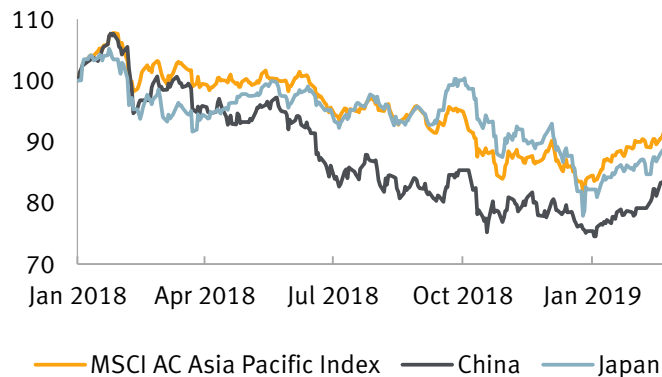
Asia

- The MSCI AC Asia Pacific index continued to move higher in February, yet remains well below its record high reached in January 2018.
- Equities in Asia have been buoyed by some progress on the trade negotiations between the U.S. and China. While the situation is complex, with many large issues up for discussion, the likelihood that

some kind of deal will be struck appears to be increasing. This would probably be viewed as a positive by investors, even if the deal is only partial. However, even if a deal is struck, the story will be far from over. We maintain the view that the nature of the strategic relationship between the U.S. and China has changed for the worse on multiple fronts with little chance of improvement.

- Generally, equity valuations in Asia remain somewhat depressed and below five-year averages. However, earnings growth has also come under pressure. We maintain a preference for Japan. The TOPIX Index has recouped its losses from the sharp December correction. Japanese equities are inexpensive and we expect the yen to weaken against the U.S. dollar. Investors should note that the index is fairly sensitive to global leading economic indicators.

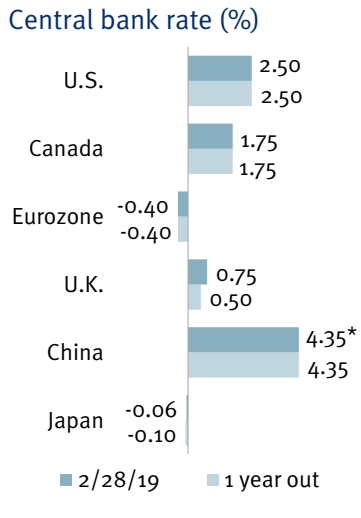
Asian index performance since 2018



The rally in Asian equities that started in late 2018 is evident, but major indexes remain clearly below the early 2018 highs.

Note: Local currency returns indexed to 100; China index is the Shanghai Composite, Japan is the TOPIX
 Source - RBC Wealth Management, Bloomberg; data through 2/28/19

Things that go bump in the night—deliver us!



We borrow this title from an old Scottish prayer, which asks for divine deliverance “from ghoulies and ghosties, and long-legged beasties” to discuss concerns that have been rattling around the global markets in recent months. With the benefit of hindsight and possibly divine—but more likely central bank—intervention, it appears that investors may have been delivered.

Central bank policy convergence redux

Monetary policy convergence was a 2018 theme, the idea being the Federal Reserve would be joined by other global central banks in a steady march to remove/reduce extraordinary monetary policy stimulus. The Bank of Canada got the message and moved in near lock-step with the Fed, and the Bank of England inched over the starting line, but for many others it was a failure to launch. As a result, convergence quickly became divergence. In 2019 we think the stage is once again being set for monetary policy convergence led by the Fed. But this time it could be a move toward easy street, or at least easing off the brake.

Interest rate head fake

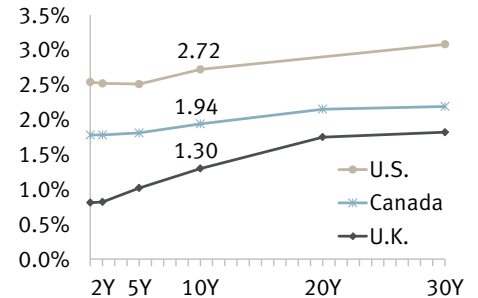
October 2018 was a heady time as benchmark interest rates were on the rise and dire predictions of significantly higher rates were fueled by optimistic growth projections and concerns over higher inflation. The 10-year Treasury yield peaked at 3.244% and this pulled other benchmark yields higher. Some benchmark yields are now approximately 50–60 basis points

Fixed income views

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

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

Sovereign yield curves



Source - Bloomberg

lower, as softening global economic conditions and low inflation have reduced expectations for central bank rate hikes. In our opinion, this has effectively capped interest rates—meaning it is likely we have seen the peak rates for this cycle.

Recession is just another word ...

... for periods of distress and contraction, which are common to most economic cycles. They are typically short, lasting nine to 18 months, and the National Bureau of Economic Research (NBER) is, among

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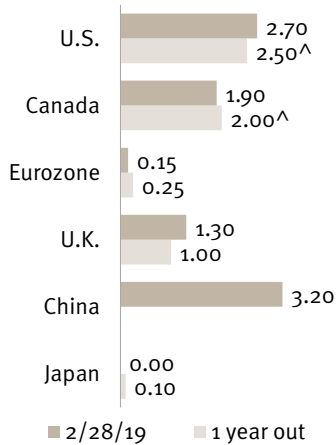
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Global fixed income

10-year rate (%)



Note: Eurozone utilizes German Bunds.
 Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management
[^]Under review

other things, called on to identify when recessions begin and end. Its recession “scorecard” focuses on five economic indicators: real GDP, income, employment, manufacturing, and retail sales. To the NBER, a lengthy (six-month) decline in these indicators represents a recession. Clearly, the current expansion is in the late-cycle stage, and some of these indicators have begun to show signs of deterioration. But as we’ve said previously, “late cycle is not end of cycle” and to us the next recession is not yet imminent based on these indicators and others we monitor.

Regional highlights

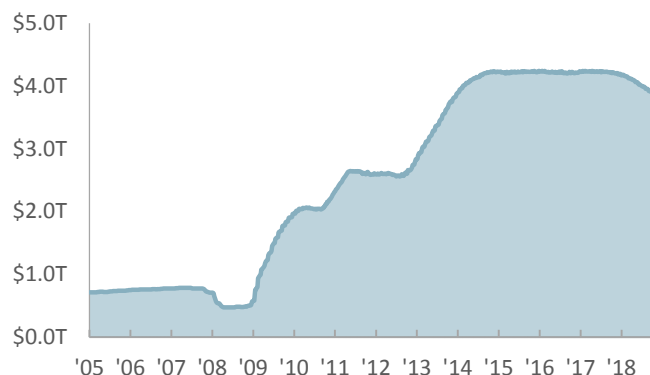
United States

- The Federal Reserve started the process of “normalizing” its balance sheet back in late 2017 when its portfolio of securities stood at \$4.2T, up from roughly \$800B in 2007. The Fed’s balance sheet now sits at a still-sizeable \$3.8T, but the Fed’s January meeting minutes indicate it is looking to end the normalization process later this year. While that size may not seem “normal,” we have long thought the ultimate size of the balance sheet would be around \$3.5T, largely due to economic growth dynamics. The impact of this process should

mean less issuance of new Treasuries, and more demand for outstanding Treasuries, with the net effect likely being lower Treasury yields, all other factors being equal. We maintain our view that the 10-year Treasury yield will hold below 3.0% through at least 2019.

- While recession fears linger amid economic data that has soured of late, Q4 GDP growth of 2.6% outpaced expectations of 2.2%. Credit markets continue to trade as if there’s little risk on the horizon as speculative-grade credit spreads, or the yield compensation over Treasuries for credit risk, have tightened sharply to just 3.79%, from a peak of 5.37% in January. Prior to past recessions, credit spreads have typically jumped to over 8.0%, meaning that today’s levels have historically signaled a sanguine economic outlook.
- The short end of the municipal bond yield curve, inside of five years, is only getting richer. At the start of the year, munis yielded 80% of Treasuries and equaled the five-year average. At the end of February they yielded just 69%. The long end of the muni curve remains steep, and yields 102% of Treasuries, about equal to average levels. So again, we recommend muni buyers look to put money to

The Federal Reserve’s total holdings of Treasuries and mortgage-backed securities



Despite shrinking its balance sheet by just \$460B since the end of 2017, the Fed is already eyeing an end to balance sheet normalization.

Source - RBC Wealth Management

work further out on the yield curve, particularly as we anticipate Treasury yields will trade around current levels for the balance of the year.

Canada

- Government of Canada yields remain suppressed as the bond market has now priced out any additional Bank of Canada (BoC) rate hikes during this expansion. Recent data suggests GDP growth moderated in Q4 2018, leaving the economy operating slightly below capacity. The BoC expects this shortfall to be temporary although the bond market remains skeptical. The level of inflation priced into bonds is currently muted and there are no rate hikes priced into either the U.S. or Canadian markets. Given both central banks appear to be on hold for the time being, Canadian bond yields could drift higher over the course of the year if commodities continue to nudge higher and inflation expectations increase. We remain biased to discounted federal bonds and would consider inflation-linked bonds as well.
- Canadian investment-grade spreads have followed the global trend and tightened sharply so far in 2019, removing any worthwhile valuation advantage. We continue to operate with a higher-quality bias, which has only been reinforced with the recent tightening in spreads.
- Preferred shares have retraced their January rally and appear to be one of the only risk assets in global financial markets not to have delivered positive total returns so far this year. Implied credit spreads are much wider than what other fixed income instruments have on offer, and are also wide compared to recent history within the asset class, leading

us to find a number of attractive opportunities. Concerns over the length of the economic/interest rate cycle hold us back from a stronger buy recommendation in the near term.

Continental Europe & U.K.

Europe

- With the European economic slowdown “broader and more persistent” and the data since December “much weaker” than expected, focus is building on the March meeting of the European Central Bank (ECB)—not just on updated growth estimates, but also on the bank’s monetary policy guidance. ECB Chief Economist Peter Praet has alluded to what the central bank is thinking. This has provided support to the European periphery as well as German 10-year bond yields, which have rallied to 0.18%, the lowest level in over two years.
- The ECB has provided reassurance that some replacement or new form of targeted longer-term refinancing operations (TLTRO) will be announced to support the current bank transmission process. The market expects that the central bank’s guidance of rates remaining low “at least through the summer of 2019” is going to be pushed further into late 2019 or 2020, with the current level of monetary accommodation to persist for longer. This provides support for maintaining our Market Weight position in government bonds and modest Overweight in corporate credit.

U.K.

- In the U.K., with the overhang of Brexit negotiations persisting and a lack of support in Parliament for the Withdrawal Agreement, Gilt yields have continued to push lower. Recent comments from one external member

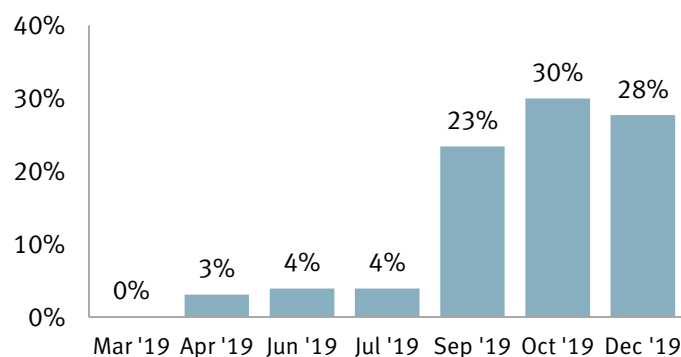
of the Bank of England's Monetary Policy Committee point to the next interest rate hike potentially not occurring until growth headwinds have shown signs of fading. For now, we maintain a Market Weight view on U.K. government bonds with short-duration positioning; however, the final weeks of negotiations leading up to the U.K.'s scheduled exit from the EU at the end of March will be crucial in determining positioning for the remainder of the year. We also see the yield pickup in corporate credit as attractive, albeit on a selective basis, and continue to be Market Weight in our allocation.

Asia

- We have moved to a neutral stance on Asian credit compared to the previous two months of 2019 as the market has rallied significantly in a short period of time. The combination of a more dovish Fed and a more optimistic outcome from the U.S.-China trade dispute continues to be the driving force across most emerging markets, particularly in Asia. The Bloomberg Barclays Asia Ex-Japan USD Credit Index has returned 3.33% year to date, where the high-yield component outperformed by returning 5.22% while the high-grade component delivered only 1.97%. We maintain
- our preference for high yield over high grade in Asia mainly due to valuations.
- The Chinese economy seems to be hitting a soft patch with the Caixin Manufacturing PMI dipping into contraction territory in January at 48.3. It was the lowest level since March 2016, but it should not be a surprise as the government has continued to implement structural reforms and to encourage deleveraging across the economy. We expect consumption data to remain soft for the rest of 2019, and credit default risks to pick up going forward. Therefore, we reiterate our preference of quality high yield, i.e., no lower than BB-rated names, and would favor extending duration for stronger credits rather than moving lower on the credit spectrum.
- The People's Bank of China introduced a Central Bank Bills Swap (CBS) to support the liquidity of banks' perpetual bonds. This allows primary dealers, mainly banks, that hold perpetual bonds issued by qualified banks to swap for Central Bank bills. The new measure should help banks to replenish their capital via perpetual bond issuance, which in turn may help support the economy via faster loan growth.

How the market is pricing ECB rate hike chances

Months with ECB meetings scheduled



Heading the ECB's pledge to keep rates low through the summer, the market is not pricing a material chance of a rate hike until September.

Source - RBC Wealth Management, Bloomberg

Currencies

Currency forecasts

Currency pair	Current rate	Forecast Dec 2019	Change*
Major currencies			
USD Index	96.15	96.84	1%
CAD/USD	0.75	0.75	0%
USD/CAD	1.31	1.33	2%
EUR/USD	1.13	1.16	3%
GBP/USD	1.32	1.25	-5%
USD/CHF	0.99	1.03	4%
USD/JPY	111.39	120.00	8%
AUD/USD	0.70	0.67	-4%
NZD/USD	0.68	0.63	-7%
EUR/JPY	126.67	139.00	10%
EUR/GBP	0.85	0.93	9%
EUR/CHF	1.13	1.20	6%
Emerging currencies			
USD/CNY	6.69	7.50	12%
USD/INR	70.74	80.00	13%
USD/SGD	1.35	1.44	7%

* Defined as the implied appreciation or depreciation of the first currency in the pair quote. Examples of how to interpret data found in the Market Scorecard. Source - RBC Capital Markets, Bloomberg

U.S. dollar: Pausing with the Fed

Performance in the U.S. dollar has been mixed so far in 2019. The currency has taken cues from swings in risk sentiment as investors digest U.S.-China trade developments and growing signs of a protracted slowdown in global economic growth. U.S. dollar support should persist until there is evidence of improving growth conditions abroad; however, with the Fed apparently on hold, the main impetus for any further dollar strength has ebbed.

Euro: Under pressure

Headwinds facing the euro area economy persist and, in turn, are contributing to the euro slipping lower across major currencies. Despite the near-term challenges, a reassertion of growth momentum alongside building wage pressures should see the ECB raise its key policy rate later this year. With financial markets having shifted away from anticipating such a move, we see scope for the euro to trend higher later in 2019.

British pound: Tick tock ...

The British pound has been caught in the crossfire of Brexit headlines, with shifts in market sentiment towards a deal being reached ostensibly driving swings in the currency. We remain of

the view that a deal will be reached either in advance of March 29, 2019, or an extended exit date; however, caution is warranted given that the risk of the U.K. leaving without a deal remains the default option.

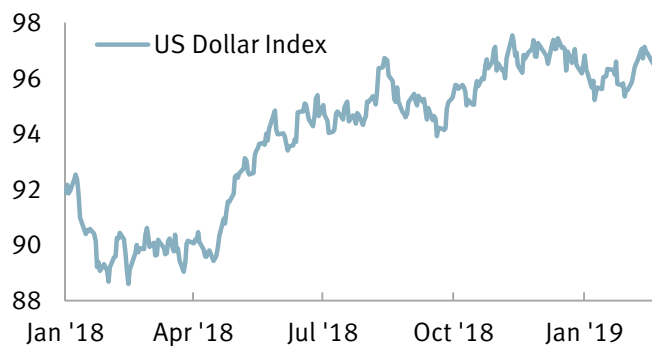
Canadian dollar: Soft growth prompts a pause

The Canadian dollar recorded the strongest gains amongst G10 currencies in January as it benefitted from firmer crude oil prices, improved risk appetite, and the emergence of broad U.S. dollar weakness. The uptrend started to fade in February, however, and a diminished near-term growth outlook alongside signals that the Bank of Canada will pause in its policy tightening path could limit further gains in 2019, in our view.

Japanese yen: Rally fades for now

Growing optimism for progress on the U.S.-China trade front alongside evidence of domestic growth challenges underpinned renewed yen weakness in 2019 after a strong rally in the final weeks of 2018. Choppier market conditions amidst ongoing geopolitical tensions could spur bouts of risk-off sentiment and provide support for the yen, yet domestic headwinds are likely to cap gains and underpin our neutral yen outlook.

The U.S. dollar remains resilient, for now



Deteriorating global growth conditions and uncertainty on the trade front have supported the dollar.

Source - RBC Wealth Management, Bloomberg; data through 2/20/19

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Commodity forecasts

	2019E	2020E
Oil (WTI \$/bbl)	55.85	64.00
Natural Gas (\$/mmBtu)	3.00	2.75
Gold (\$/oz)	1,300	1,300
Copper (\$/lb)	2.63	3.00
Soybean (\$/bu)	9.63	9.85
Wheat (\$/bu)	5.05	4.95

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

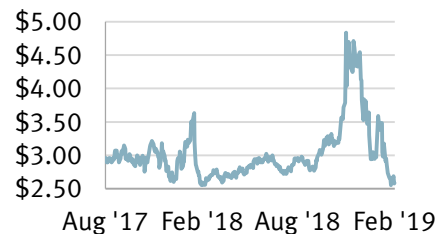
Oil — WTI: More cuts to come

Crude prices have rallied more than 30% off their December lows on U.S.-China trade optimism and supply cuts. However, OPEC cut its 2019 global demand forecast on the backs of slowing global growth. Saudi Arabia announced additional cuts of 500,000 bbl/d in March. The U.S. also imposed sanctions on Venezuela, which should result in further declines in that country's heavy oil production, providing additional price support.



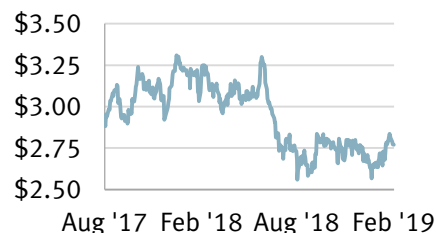
Natural gas — Made in America

Prices have moderated since hitting a high of \$3.59/MMBtu in January. The EIA is forecasting domestic dry gas production of 90.2 bcf/d in 2019, up roughly 8% y/y. Key U.S. LNG developments should begin exporting this year. The lack of clarity on the trade front could cap the number of new North American LNG projects given Asia is the largest importer. In our view, prices will be restrained by growing new supplies together with uncertainty on the demand front.



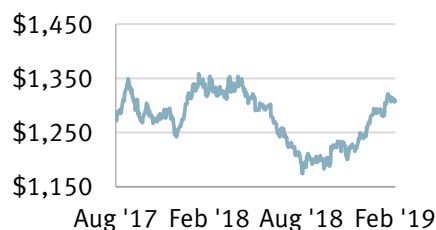
Copper — Enter the Cobre

Prices are up roughly 5% so far in 2019, but are still 14% lower y/y. We expect prices to be range-bound in the near-to-medium term; however, China's stimulus efforts and any positive trade dispute resolution could deliver price strength later in the year. The ramp-up of Cobre Panama should add 150,000 tonnes to global production. This will still leave the demand/supply balance in deficit. RBC Capital Markets sees the deficit persisting for several years.



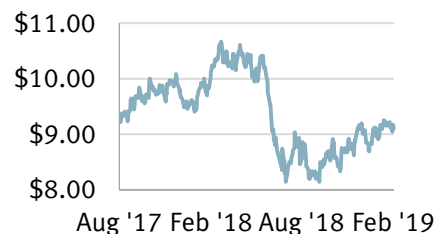
Gold — Risk-on, but for how long?

Risk assets have made a comeback thus far in 2019. Gold broke above the \$1,300 level on January 25 and managed to maintain its footing alongside the rally in the broader equity markets. With production forecast at flat-to-down for a number of years, the World Gold Council sees potential for additional price strength due to more dovish monetary policies in response to slower global growth together with political instability (e.g., Brexit) and trade uncertainty.



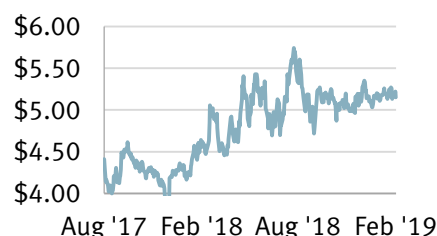
Soybeans — Left in the dark

U.S. farmers are closely monitoring trade developments as they approach the April planting season. President Trump may push the March 1 deadline for a trade agreement with China by 60 days, leaving farmers somewhat in the dark as to how much they should aim to grow for the 2019 harvest. Prior to last year's tit-for-tat tariff impositions, China typically consumed more than 50% of U.S. soybean production.



Wheat — You are what you wheat

Net global production is projected to increase by 1.3M tonnes in 2019 according to the U.S. Department of Agriculture. Russia is anticipated to provide the greatest contribution with an increase of 1.6M tonnes in production, partially offset by China's expected reduction of 1.1M tonnes. Global demand is forecast to rise by roughly 2M tonnes, driven by China's growing use in animal feed. Cooler weather may mean reduced winter plantings.



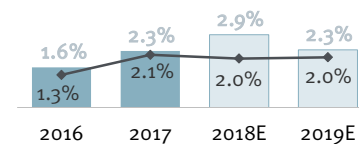
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Source - RBC Wealth Management, Bloomberg; date range: 8/14/17-2/14/19

■ Real GDP growth ◆ Inflation rate

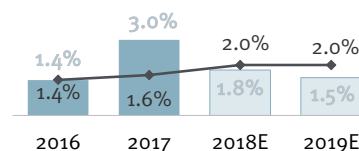
United States — The spring thaw

GDP for Q4 2018 outpaced expectations, coming in at +2.6% compared to a consensus of 2.2%. The composition of growth was solid, the only blemish being lower-than-expected consumer spending, but that was likely due to increased market volatility at the end of the year. Turning to the outlook, Q1 GDP tracking remains below 2%, but following the end of the government shutdown we have already seen a marked improvement in consumer and business sentiment from prior months, suggesting that any near-term economic weakness is unlikely to be anything more than a soft patch for the U.S. economy.



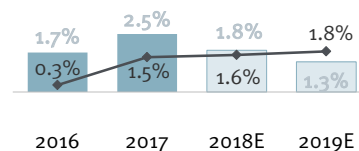
Canada — Unemployment rises for the right reasons

The pace of hiring remains robust, but a strong labor market is also drawing people back into the labor force. Despite a three-month average hiring pace of roughly 51,000 jobs added per month, labor force participation has increased at a faster clip, driving the unemployment rate up to 5.8% in February from 5.6% in January. The economic outlook remains uncertain, as recently highlighted by the BoC, but with rate hikes on hold the runway for the economy should be clear in the months ahead.



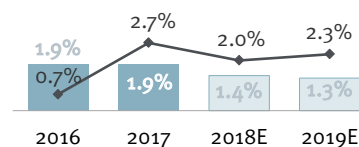
Eurozone — Germany narrowly avoids recession

ECB rate hike plans have been pushed back as Germany narrowly avoided a recession with Q4 GDP coming in at 0%, following the -0.2% decline in Q3. A recession is technically defined as two consecutive quarters of negative growth. Q1 GDP for Germany is expected to hold positive, if only just, on underlying strength in the services sector while global protectionism continues to elevate uncertainty around Germany's export-oriented economy.



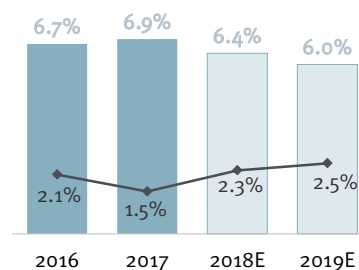
United Kingdom — Brexit delay

The Brexit drama continues, and looks like it will continue for some time. With the March 29 deadline fast approaching, Prime Minister Theresa May softened her recent tone, opening up the possibility of a short-term extension. On the data front, the U.K. manufacturing PMI pulled back in January following a surprise jump to a six-month high in December, suggesting a slightly softer growth trajectory to begin the year.



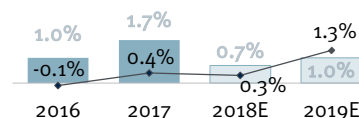
China — Benefits of trade

China's stock market has been the primary beneficiary of growing optimism that the U.S. and China are nearing a trade deal, with the Hang Seng Index up nearly 12% to start the year, following an 11% decline in 2018. Additionally, China has taken steps to shore up the growth outlook via various forms of increased stimulus, a sign that the government is putting deleveraging plans on hold at least temporarily.



Japan — Inflation firms, but exports wane

Inflation picked up in January with core inflation rising to 0.80%, but the BoJ's 2% target remains a long way away. Global protectionism continues to weigh on the outlook, with exports falling -8.4% y/y in January. But recent optimism around a possible U.S.-China trade deal may have a positive impact for Japan on reduced uncertainty around global supply chains.



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

Market scorecard

Index (local currency)	Level	1 month	YTD	12 month
S&P 500	2,784.49	3.0%	11.1%	2.6%
Dow Industrials (DJIA)	25,916.00	3.7%	11.1%	3.5%
NASDAQ	7,532.53	3.4%	13.5%	3.6%
Russell 2000	1,575.55	5.1%	16.8%	4.2%
S&P/TSX Comp	15,999.01	2.9%	11.7%	3.6%
FTSE All-Share	3,888.81	1.7%	5.8%	-2.3%
STOXX Europe 600	372.80	3.9%	10.4%	-1.8%
EURO STOXX 50	3,298.26	4.4%	9.9%	-4.1%
Hang Seng	28,633.18	2.5%	10.8%	-7.2%
Shanghai Comp	2,940.95	13.8%	17.9%	-9.8%
Nikkei 225	21,385.16	2.9%	6.8%	-3.1%
India Sensex	35,867.44	-1.1%	-0.6%	4.9%
Singapore Straits Times	3,212.69	0.7%	4.7%	-8.7%
Brazil Ibovespa	95,584.35	-1.9%	8.8%	12.0%
Mexican Bolsa IPC	42,823.80	-2.6%	2.8%	-9.7%
Bond yields	2/28/19	1/31/19	2/28/18	12 mo. chg
US 2-Yr Tsy	2.51%	2.46%	2.25%	0.26%
US 10-Yr Tsy	2.72%	2.63%	2.86%	-0.15%
Canada 2-Yr	1.78%	1.78%	1.79%	-0.01%
Canada 10-Yr	1.94%	1.88%	2.24%	-0.29%
UK 2-Yr	0.83%	0.76%	0.78%	0.05%
UK 10-Yr	1.30%	1.22%	1.50%	-0.20%
Germany 2-Yr	-0.52%	-0.56%	-0.54%	0.02%
Germany 10-Yr	0.18%	0.15%	0.66%	-0.47%
Commodities (USD)	Price	1 month	YTD	12 month
Gold (spot \$/oz)	1,313.31	-0.6%	2.4%	-0.4%
Silver (spot \$/oz)	15.61	-2.8%	0.7%	-4.9%
Copper (\$/metric ton)	6,555.50	6.6%	10.2%	-4.9%
Uranium (\$/lb)	20.90	-0.5%	-12.6%	-7.7%
Oil (WTI spot/bbl)	57.22	6.4%	26.0%	-7.2%
Oil (Brent spot/bbl)	66.03	6.7%	22.7%	0.4%
Natural Gas (\$/mmBtu)	2.81	-0.1%	-4.4%	5.4%
Agriculture Index	278.14	-3.9%	-2.0%	-8.5%
Currencies	Rate	1 month	YTD	12 month
US Dollar Index	96.1570	0.6%	0.0%	6.1%
CAD/USD	0.7589	-0.4%	3.5%	-2.6%
USD/CAD	1.3172	0.4%	-3.4%	2.7%
EUR/USD	1.1371	-0.7%	-0.8%	-6.7%
GBP/USD	1.3263	1.2%	4.0%	-3.6%
AUD/USD	0.7094	-2.5%	0.6%	-8.6%
USD/JPY	111.3900	2.3%	1.5%	4.4%
EUR/JPY	126.6700	1.6%	0.7%	-2.6%
EUR/GBP	0.8574	-1.8%	-4.6%	-3.2%
EUR/CHF	1.1349	-0.3%	0.8%	-1.5%
USD/SGD	1.3521	0.5%	-0.8%	2.1%
USD/CNY	6.6941	0.0%	-2.7%	5.7%
USD/MXN	19.2813	0.9%	-1.9%	2.4%
USD/BRL	3.7564	3.0%	-3.2%	15.7%

Chinese stocks have been the largest beneficiaries of trade resolution optimism.

The Germany 10-year is nearing negative territory for the first time since 2016 as growth fades.

Raw material indexes are up sharply this year, led by copper, as China boosts stimulus measures.

The pound has strengthened against the euro as Brexit could be delayed until 2021.

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 0.75 means 1 Canadian dollar will buy 0.75 U.S. dollar. CAD/USD -2.6% return means the Canadian dollar has fallen 2.6% vs. the U.S. dollar during the past 12 months. USD/JPY 111.39 means 1 U.S. dollar will buy 111.39 yen. USD/JPY 4.4% return means the U.S. dollar has risen 4.4% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 2/28/19.

Research resources

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Sell [Underperform]	77	4.83	7	9.09

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