GLOBAL Insight

Wealth Management

Perspectives from the Global Portfolio Advisory Committee

April 2022

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A new Europe in the making

As the Russia-Ukraine conflict grinds on, a changed EU will emerge in a new era.

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GLOBAL
Insight

April 2022

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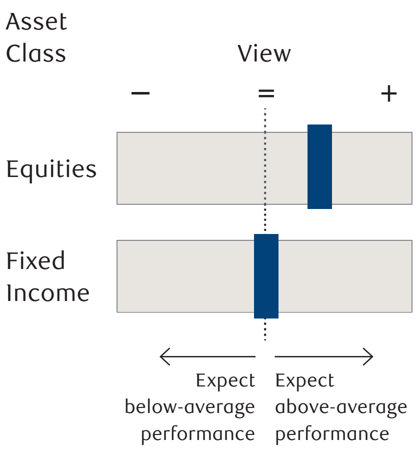

(+/=/–) represents the Global Portfolio Advisory Committee's (GPAC) view over a 12-month investment time horizon.

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

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

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

Source - RBC Wealth Management

EQUITIES

- Equities have been volatile so far this year, first due to ongoing inflation pressures and concerns about the impact that more aggressive central bank rate hike plans might have on economic growth. Then the market was jolted by the Russia-Ukraine conflict and related supply chain and commodity price pressures stemming from Western sanctions on Russia, the world's largest commodity producer. At the most acute point during Q1, the S&P 500 had retreated 13.1% from its all-time high, and most developed markets outside of the U.S. fell by roughly the same amount as measured by the MSCI World ex US Index. Notably, the odd man out was Canada's S&P/TSX Composite, which barely paused and has been in new high ground for several weeks.
- While most markets have recovered much of their lost ground since then, vulnerabilities persist because the range of potential outcomes for the U.S. and global economies and for corporate earnings growth are now much wider than they were just a few months ago—and there are downside risks. We continue to be guided by the principle that U.S. recession risks matter most. When these risks are low, stocks should be given the benefit of the doubt. Despite ongoing inflation, Fed tightening, and other headwinds, our seven U.S. leading indicators of recession continue to give the U.S. economy a unanimous "green light." We expect the U.S. economy and corporate earnings to continue to grow in 2022, and the market to ultimately work through the challenges. We maintain our moderate Overweight portfolio exposure in equities.

FIXED INCOME

- Government bond yields continue to move higher as inflationary pressures are expected to lead to tighter monetary policy. Despite the turmoil caused by Russia's invasion of Ukraine, the Fed and other central banks remain likely to continue the process of removing policy accommodation, with the potential for more aggressive, front-loaded rate hikes by the Fed once again increasing. As a result, Treasury yield curves continue to flatten as short-term yields rise faster than long-term yields, while certain segments have briefly inverted. While inversions are historically a signal of impending recession risks, we think 12-month recession risks remain low, and that yield curves will have to invert more significantly than in past economic cycles to signal heightened recession risks.
- With long-term yields now at or near our target levels, we favor shifting duration positioning to Neutral. To compensate for greater sensitivity to changes in interest rates, we maintain an Underweight exposure to government bonds while looking for opportunities to increase our exposure to corporate bonds, which have sold off post-invasion.
- We maintain our Market Weight in global fixed income with a Market Weight allocation to corporate credit.

MONTHLY
Focus

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A new Europe in the making

Longer term, the Russia-Ukraine war will certainly transform the European economic and geopolitical order. Peace can no longer be taken for granted. While a dark cloud has descended over the continent today, we believe opportunities in the region remain.

Long-term implications

No matter what the outcome of the war may be, a changed EU will emerge in a new era. We highlight key areas of transformation, including a move towards more regional cohesiveness; a revving up of the green energy transition; the absorption of the large influx of refugees; and a relaxation of attitudes towards fiscal discipline.

Greater cohesion

The bloc surprised many by the decisiveness displayed in swiftly imposing a punishing package of sanctions against Russian oligarchs and institutions. Russia's invasion of Ukraine has galvanised the EU to open its coffers, including providing Ukraine with €1.2 billion in financial and humanitarian aid and €450 million of military assistance. EU leaders have also accepted Ukraine's application for EU membership—though the process may well take another 10 years.

The conflict spurred a radical change in Germany's defence policy almost overnight. Chancellor Olaf Scholz approving the export of lethal weapons to a conflict zone for the first time since World War II is a pivotal action that could encourage further EU cohesion.

The war has also dulled the appeal of eurosceptic parties, both on the far right and far left, which often cited Russian President Vladimir Putin as a role model. This likely reduces the risk of an anti-EU government being elected in France or Italy (elections to be held in April 2022 and in 2024, respectively), and probably positions the bloc more firmly in the center.

Yet we shouldn't expect complete cohesion on all matters. For one, unlike trade policy where the EU can legislate like a sovereign government, EU foreign and security policy is intergovernmental, so the EU can only act when all members agree. The threat posed by the invasion of Ukraine was so menacing that all members swiftly agreed on a course of action. Had the threat been somewhat less ominous, we believe the EU would have reverted to building a compromise among all members, a process that likely would have prevented it from acting quickly. In other words, as long as the veto system is in place, the EU continues to run the risk of being bogged down in lengthy negotiations among its 27 member states.

French President Emmanuel Macron has been arguing that the time has come for an EU-wide defence policy. This would require amending the EU treaty to do away with the veto system, a move many members remain reluctant to support.

Having said that, fresh on the heels of the success of the EU's coordinated response to COVID-19, the threat of menacing external aggression will likely shift the balance towards a greater tolerance for EU-level decisions, as opposed to at the national level, as EU member states reflect on common interests and objectives.

The adoption by EU foreign and defence ministers on March 21, 2022 of a "Strategic Compass"—a plan to strengthen the EU's security and defence policy over the next decade—goes some way to better coordinate EU members in this matter.

Revving up the green transition

Because Europe's heavy dependence on Russian energy is clearly undesirable, the European Commission has proposed a three-step plan, REPowerEU, to reduce it. In contrast to the U.S., which has banned Russian oil imports, the EU's plan involves a more gradual approach to wean itself off Russian energy.

Share of Russian energy imports for key EU countries

Eastern member states are the most dependent

Country	Russia's share of total gas imports
Slovakia	100%
Hungary	95%
Bulgaria	79%
Poland	55%
Germany	49%
Italy	47%
Netherlands	27%
France	20%
Spain	9%
Belgium	8%
Portugal	2%
Austria	0%

Greater exposure

Less exposure

Country	Russia's share of total crude oil imports
Slovakia	78%
Lithuania	69%
Poland	68%
Finland	67%
Netherlands	38%
Germany	30%
Italy	17%
France	8%
Ireland	5%
Portugal	4%
Luxembourg	0%

Source - World Bank, Eurostat, International Energy Agency

REPowerEU calls for reducing Russian energy imports by 65 percent over the remainder of this year and completely before 2030. This will require long-term investments in renewables and energy efficiency, as well as short-term measures such as purchasing non-Russian oil, liquefied natural gas (LNG), and coal; greater use of nuclear energy; and reducing energy demand by, for instance, encouraging consumers to lower home temperatures by one percent. The plan also aims to increase gas reserves to 90 percent of capacity, versus 30 percent currently, by Oct. 1 each year so as to improve the system's resiliency.

It is up to each member state to decide how these goals will be reached. For example, Germany's initial response was to bring forward its target of 100 percent renewable energy by more than a decade to 2035, a move which requires a €200 billion commitment to almost triple onshore wind and solar capacity, and more than double offshore wind. In the short term, Germany is considering prolonging the use of coal beyond 2030, and it announced plans to build two LNG terminals whilst bolstering gas and coal storage.

Member states' action plans to reduce dependency on Russian energy

Renewables play a key role

Headline	Date
Netherlands ramps up plan for doubling offshore wind capacity by 2030	18-Mar-22
Belgium poised to delay 2025 nuclear power exit	17-Mar-22
France ends gas heater subsidies, boosts heat pumps in bid to cut Russian reliance	16-Mar-22
The Mediterranean Sea gets first offshore wind farm as Italy vows energy revolution	16-Mar-22
Germany to speed renewables push due to Ukraine crisis	28-Feb-22

Source - Thomson Reuters, France24

Many wonder if the new imperative of replacing Russian energy imports means abandoning the net-zero goal as the EU will need to reopen coal plants and rely on nuclear energy for a longer period of time. But the situation is not so clear cut, in our view.

Bloomberg estimates that burning additional coal instead of Russian gas would increase the EU's carbon emissions by about eight percent. But it points out that as Europe isn't planning to construct new coal power plants as part of its response to the crisis, any pollution created by new coal and oil imports could be offset by green replacements that will likely be scaled up. Still, boosting additional sources of gas, which European homes rely on for heat, and building the required infrastructure, such as the two proposed German LNG terminals, will lock in gas consumption for decades.

Most importantly, the green transition has moved up the agenda, from being an environmental issue, to becoming a security matter.

Absorbing the influx of refugees

Ukrainian refugees could have a significant effect on the rest of Europe. Already, some three million people have fled Ukraine. The UN's estimate of four million refugees by the end of the conflict is very likely to be surpassed.

Eric Lascelles, chief economist at RBC Global Asset Management Inc., points out that some will return when the war is over, especially since most Ukrainian men remain in the country, though many refugees will not, either because of the destruction to Ukraine or the economic opportunities that wealthier European nations can offer.

He estimates the EU population could well grow by at least one percent in short order. Such migrations are not friction-free, as demonstrated in

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A new Europe in the making

2014–2015 when many refugees arrived in Europe from the Middle East and Africa. But as the migrant population settles and gains employment, Lascelles sees the opportunity for a period of faster eurozone economic growth that could last for several years.

In the shorter term, absorbing such an influx of people will be challenging. The welcoming effort so far is largely privately-driven. Should the conflict drag on for an extended period, EU leaders will have to address how to best integrate refugees into society and the economy.

Fiscal relaxation

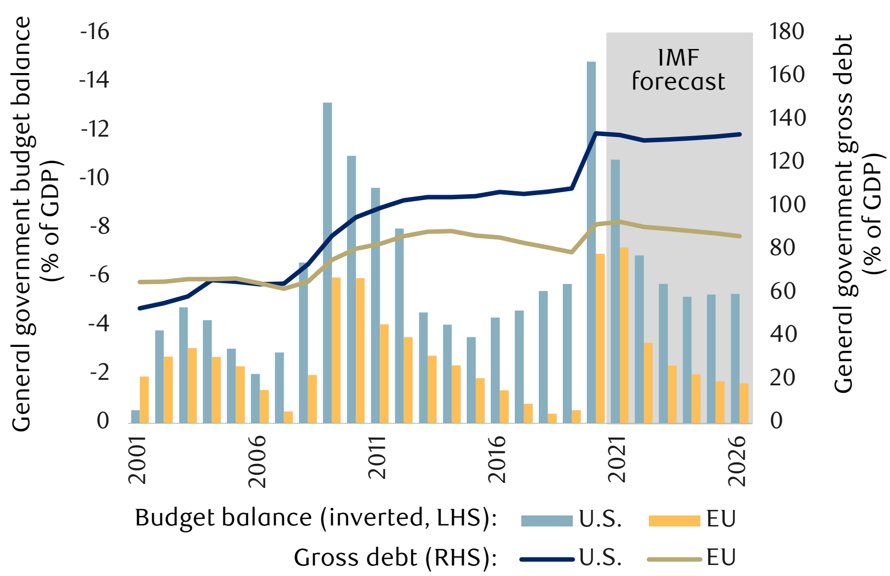
Attitudes towards fiscal support are evolving. German Finance Minister Christian Lindner is now advocating for increased defence spending representing 2.7 percent of the country's GDP, with possible increases thereafter. A more constructive tone from Germany, long a fiscal hawk, could suggest the outcome of the EU's review of fiscal policy, a key topic under discussion this year, may allow governments to run budget deficits at an adequate level as opposed to the straightjacket of fiscal rectitude. A more relaxed fiscal stance could underpin growth.

Lascelles notes there is scope for this approach, as fiscal deficits and public debt in Europe are relatively smaller than those in the U.S.

Spending will take many forms. The EU and its member states are looking to protect lower-income households and vulnerable small and medium-sized enterprises from soaring energy prices. We already saw some measures taken last autumn when prices started to spike. But as prices will more than likely remain elevated for some time, national governments, such as France and Germany, are looking to subsidise energy costs or remove gas taxes temporarily. So far, such measures amount to under one percent of member state GDPs.

EU fiscal deficit and gross debt as a percentage of GDP (IMF's pre-conflict projections)

EU deficit and debt could grow further



Source - IMF World Economic Outlook (October 2021), RBC Global Asset Management

Spending on energy infrastructure, such as the two German LNG terminals, is another key area of expenditure. Germany's pledge to meet NATO's target for defence spending of two percent of GDP led other member countries to announce similar long-term commitments, though not all will be able to follow suit given other spending requirements.

EU-wide defence spending is needed to fill capability gaps so as to improve military readiness, according to the Centre for European Reform, a think tank that focuses on European integration. At an informal summit in Versailles on March 10–11, EU heads of state agreed to a "substantial" increase in defence spending.

The debate has started as to how this will be financed. At the summit, EU national leaders agreed on the priorities of defence, energy, and economic resilience and discussed a spending programme of up to €2 trillion.

Macron put forward the idea of more joint EU borrowing. There was a general recognition that the €750 billion recovery fund to help member countries weather the pandemic had been productive by providing fiscal flexibility, enabling the EU to coordinate loans and transfers, and allowing for the issuance of debt at the EU level. In effect, the recovery fund was seen as a prototype for the response to the current crisis.

The discussion is evolving towards whether there is scope to use the recovery fund to underpin new initiatives as not all funds have been released—some member states perceive this option as more prudent. Over time, more joint debt issuance is likely, in our view. We think the probable re-election of Macron in April, as expected by a wide array of pollsters, could speed up this process.

The summit launched a dynamic framework for the March meeting of the EU Council and the forthcoming gathering in June where more details will be discussed.

Short-term pain

Elevated energy costs, supply chain disruptions, and reduced demand as the uncertainty of the war dampens consumer spending will all conspire to dent the European economic recovery in 2022, in our opinion. Thankfully, this unwelcome turn comes after the region's economy started the year on a relatively strong footing, benefiting from the lifting of COVID-19-induced restrictions.

Nevertheless, economic forecasts are being revised down. Lascelles recently further fine-tuned his 2022 projection for the eurozone's GDP growth to 2.5 percent, down from 3.8 percent early this year. More adjustments are likely in light of the rapidly evolving situation.

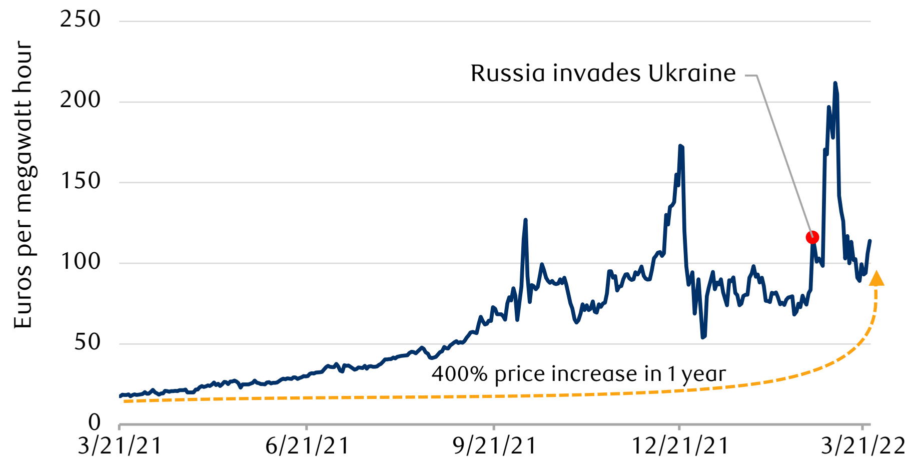
The recent decline in energy prices could give the region some respite and we are also watching for potential fiscal spending announcements, as such injections could lift growth. But the impact of the war on consumer and business sentiment, and whether energy-intensive companies have to cut output should there be further restrictions on Russian energy—be they imposed by the EU or Russia turning off the taps—could weigh further on economic activity.

MONTHLY FOCUS

A new Europe in the making

Prices have retreated from their peak but remain very elevated

Dutch natural gas spot prices



Note: Natural gas prices can vary widely between EU countries, though they have followed similar trajectories

Source - RBC Wealth Management, Bloomberg; data through 3/24/22

Lascelles looks for inflation to peak higher this year as a result of the conflict, at around eight percent year over year. Worried about such a high level, and the impact of the war on economic growth, the European Central Bank (ECB) is angling for some flexibility. While it announced it will accelerate the reduction of its asset purchase programme, now aiming to end it in Q3, the ECB also suggested it could increase bond buying again if circumstances warranted. Furthermore, the ECB's statement after the March 10 policy meeting omitted the comment that rates could rise shortly after the end of asset purchases. RBC Capital Markets expects the ECB won't increase interest rates before 2023.

Stock market implications

In the medium term we expect fiscal spending should underpin growth, while over the long term the EU could eventually emerge from the conflict with stronger institutions. But the short-term outlook is nevertheless more complex than it was earlier this year.

The MSCI Europe ex UK Index is down more than 10 percent in local currency terms since its January high, leaving the index to trade at 14.3x the forward consensus earnings estimate, a steeper-than-average discount to the U.S. on a sector-neutral basis. This low level suggests that the reductions in growth forecasts largely appear to be factored into the current valuation.

Yet we think it is prudent to downgrade European equities to Market Weight from Overweight given it is a market with a relatively high proportion of cyclicals.

We still believe there is an attractive opportunity in stocks related to the green energy transition. This remains very much a priority for the EU, and, if anything, it is now seen as a security issue and not just an environmental matter. Europe continues to be a leader in this area and we think compelling opportunities can be found after the recent correction.

GLOBAL

Equity

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A fresh look at the U.S. recession scorecard

Equity investors are contending with a confluence of several economically significant developments: war in Ukraine, surging energy and commodity prices, worrying inflation data, central banks intent on tightening, and bond yields rapidly climbing above pre-pandemic levels. All these, and more, have raised concerns about the potential for broad economic weakness down the road. Those concerns have already produced a pullback in equities, and although markets appear to have regained their footing for now, more events of this kind cannot be ruled out as the year progresses. With the exception of the Ukraine tragedy, these crosscurrents seem to us part and parcel of a global economy transitioning from the high growth rates that usually accompany the first year or so of recovery from recession to the less-dynamic "middle innings" of an economic expansion. In that phase, we would expect GDP growth to remain positive (although Europe looks to be headed for some challenging quarters) while corporate earnings and share prices are likely to advance further.

Equity views

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

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

So long as the U.S. economy can avoid recession, we believe global investors should remain committed to equities. Our U.S. recession scorecard continues to give the economy a green light, although some of our seven indicators are now "less green" than others. Below, we outline the arithmetic of each with an assessment of how vulnerable each might be to turning negative.

U.S. recession scorecard

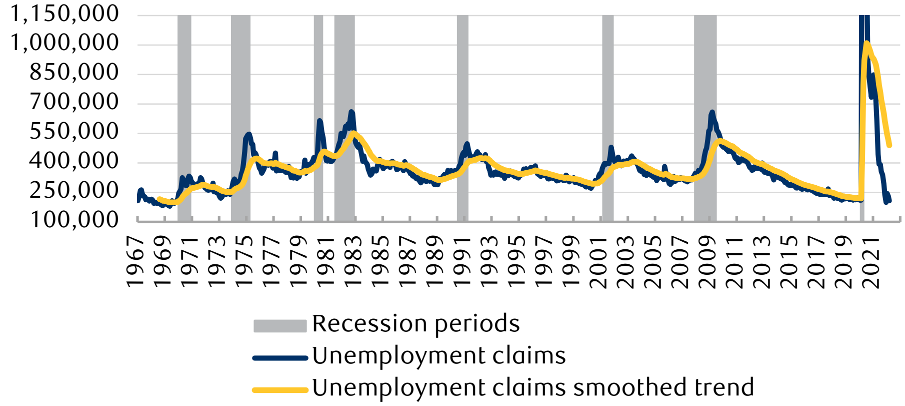
	Status		
Indicator	Expansionary	Neutral	Recessionary
Yield curve (10-year to 1-year Treasuries)	✓		
Unemployment claims	✓		
Unemployment rate	✓		
Conference Board Leading Economic Index	✓		
Free cash flow of non-financial corporate business	✓		
ISM New Orders minus Inventories	✓		
Fed funds rate vs.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

Source - RBC Wealth Management

GLOBAL EQUITY

Strong labor market

U.S. unemployment insurance claims



Note: Shaded areas indicate recessions

Source - RBC Wealth Management, Federal Reserve Bank of St. Louis (FRED); data through 3/1/22

Unemployment rate and unemployment benefit claims

These two indicators should be looked at together. The smoothed trend of the unemployment rate has usually turned upward at the start of a recession, or immediately before. It is an unusually timely indicator, as it is reported within a week after the end of each month. Although it gives very little in the way of early warning, its signals have always been visible right at the start of the economic downturn rather than months into it. This is especially useful because the start date of a recession is usually only announced definitively by the National Bureau of Economic Research about a year down the road.

The smoothed trend of the monthly average of unemployment claims has typically turned higher two to six months ahead of the unemployment rate's upward turn, giving fair warning of an approaching recession some months in advance. It has produced occasional false signals, but none of those were subsequently confirmed by the unemployment rate. It is available very close to the end of each month.

Both the unemployment rate and the number of claims would have to double from current levels over the next several months to turn their trends higher. Both are at or close to multi-decade lows, but could go even lower, in our view.

With businesses of all sizes in virtually every sector concerned by labour shortages, and with 11.3 million jobs on offer versus 6.3 million persons unemployed, we think most employers would be reluctant to lay anyone off in the near term. Even if the economy were to slow from here, we believe most businesses would go on hiring if they could find qualified applicants.

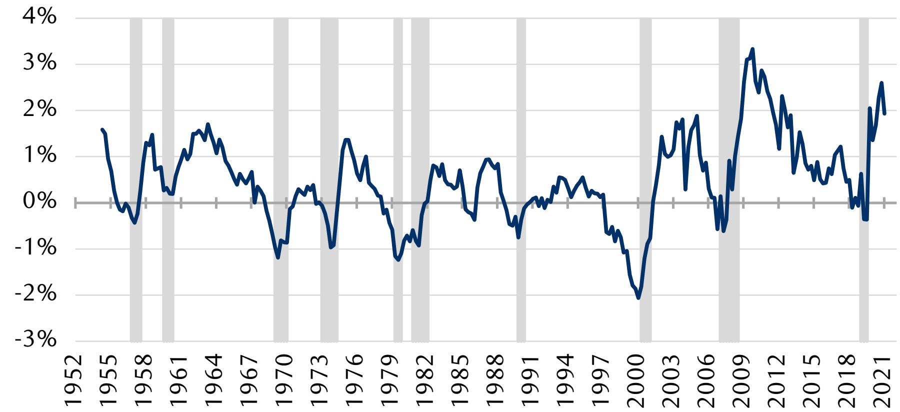
Free cash flow of non-financial corporate businesses

This indicator measures the cash generated by non-financial corporate businesses as a percentage of GDP. It is derived from the Federal Reserve's quarterly Financial Accounts of the United States, and has given only one false positive signal in more than 65 years. In all other cases when this indicator has fallen below zero, a recession has followed—typically, two to three quarters later. More particularly, shrinking corporate cash flows have most often signaled an upcoming period of weaker capital spending, a highly cyclical component of GDP. Today, this indicator looks to be in no danger of signaling an approaching recession any time soon.

GLOBAL EQUITY

Robust corporate health

U.S. nonfinancial corporate sector: Free cash flow as % of GDP (including foreign earnings retained abroad)



Note: Shaded areas indicate recessions

Source - RBC Wealth Management, Federal Reserve Bank of St. Louis (FRED); data through 10/31/21

Conference Board Leading Economic Index (LEI)

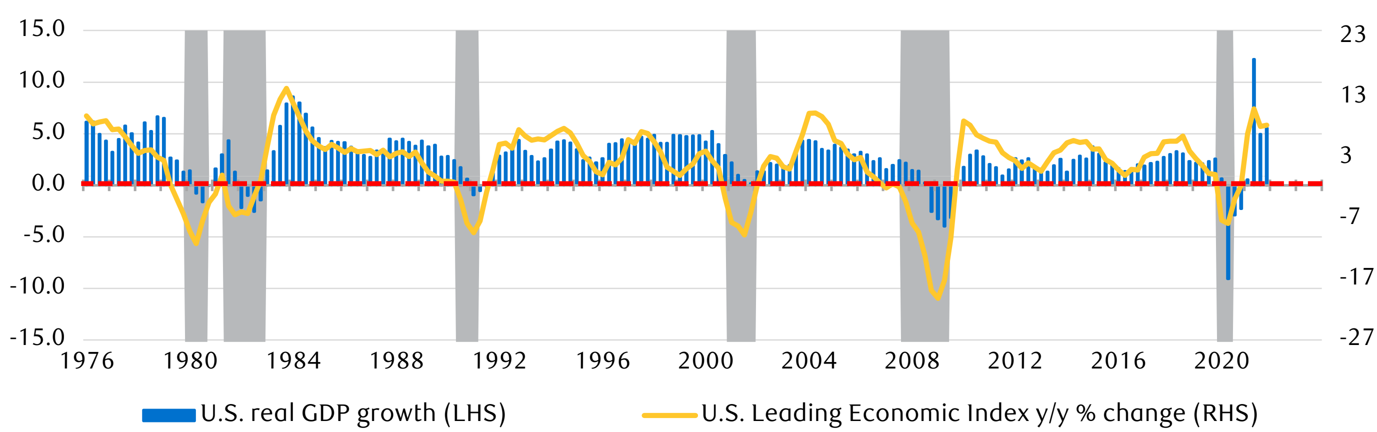
This indicator signals a recession is on the way when it falls below where it was a year ago. It has always done so at least three months before the start of a recession (the pandemic downturn being the only exception), often six months before, and occasionally earlier. The LEI may have peaked for this economic cycle in Q2 of last year, but it remains a long way above where it was a year ago. Arithmetically, we don't think this indicator could turn negative on a 12-month basis until at least late Q2 of this year, or more likely Q3—and then only if the economy were to deteriorate swiftly in the intervening months. It is one of the strongest of the recession indicators we follow, and we think it is a long way from giving a negative signal.

The yield curve

This very reliable indicator laboured in obscurity for decades, but is now followed minute-by-minute by a financial press that apparently needs something to obsess about 24/7. A yield curve inversion—that is, short-term interest rates higher than long-term rates—has preceded the start of every recession for the past 75 years,

More growth ahead

Conference Board Leading Economic Index for the U.S.



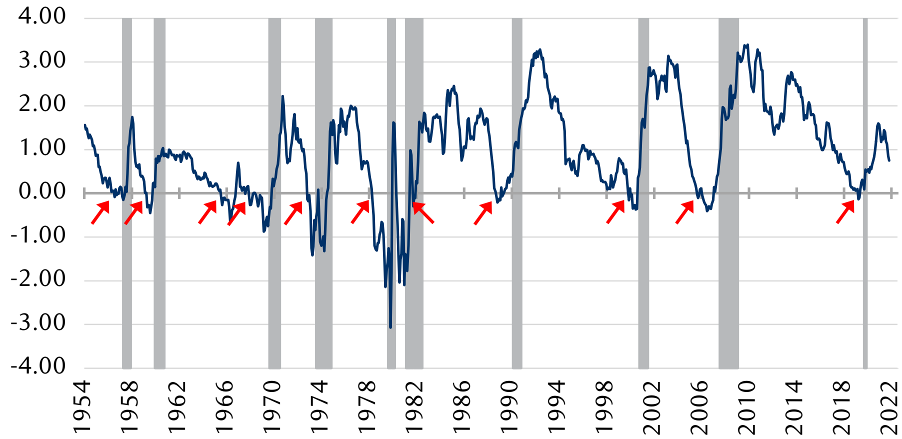
Note: Shaded areas indicate recessions

Source - The Conference Board, U.S. Department of Commerce, RBC Wealth Management; data through Q4 2021

GLOBAL EQUITY

Consistent with sustained growth

Yield differential between the U.S. 10-year Treasury Note and the 1-year Note



Note: Shaded areas indicate recessions and arrows indicate where yield curve inverts

Source - RBC Wealth Management, Federal Reserve Bank of St. Louis (FRED); data through 3/1/22

with an average lead time of roughly 11 months.

Bond trading desks typically focus on the relationship between 2-year and 10-year Treasury yields. The Fed, when it comments on this topic, typically refers to the 90-day T-Bill yield versus the 10-year. We use the 1-year Treasury yield, a quieter maturity on the curve, as our short-term component.

Yield curve inversions have occasionally occurred after stock market peaks, but never more than a month or two later, and well before the associated bear markets reached the stage of serious declines. On average, the 1-year/10-year Treasury yield curve has inverted about six months prior to the peak of the stock market.

Today, the 10-year Treasury yield is still roughly 75 basis points higher than the 1-year yield. Inversion, were it to occur, would flip this indicator to red—but as things stand, we think that possibility is a long way off. A narrowing to something under 30 basis points would induce us to shift to a more cautionary yellow (neutral) rating.

The federal funds rate versus the nominal GDP growth rate

Since 1954, the federal funds rate has typically moved above the nominal (i.e., not adjusted for inflation) year-over-year growth rate of GDP prior to the onset of a recession. There have been two exceptions: in 1957 and 2020, the funds rate crossed that threshold one month after the recession began. It is not an ideal timing tool, as there have been several false positive signals, but with the exception of the two "close calls" noted, a fed funds rate in excess of nominal GDP growth has been a precondition of all U.S. recessions.

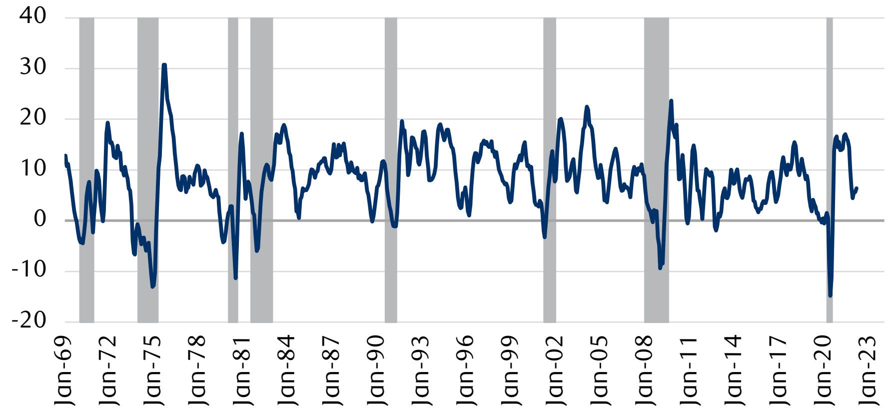
At the end of 2021, the nominal GDP growth rate stood at 10.6%, more than 10 percentage points above the 0.08% fed funds rate. We expect the year-over-year nominal GDP run rate will slow to between 7% and 8% by the end of this year, and decrease further to between 4% and 5% by late 2023.

The Federal Reserve hiked the funds rate by 25 basis points at its March meeting. The market is now pricing in a pair of 50 basis point hikes in April and June, followed by four more quarter-point increases this year and another four next year. That would put the funds rate at 2.25% by the end of 2022, and 3.25% at the end of

GLOBAL EQUITY

Support waning

ISM Manufacturing New Orders minus Inventories



Note: Shaded areas indicate recessions

Source - RBC Wealth Management; Institute for Supply Management; data through 1/4/22

2023—still well short of the projected GDP run rate, by our reckoning.

(Keep in mind that the market's forecasts of Fed rate setting are usually wrong, often spectacularly so. For example, through much of last year the market expected no Fed rate hikes in 2022, with perhaps one sneaking in by year's end.)

The Fed's own "dot plot" projection (which has a similarly uneven record of predicting rate changes) is somewhat more subdued, with the funds rate hitting 2% by the end of this year and 2.75% next year.

Getting the funds rate above our projections for nominal GDP growth within the next 12 months would require GDP to grow far more slowly than we expect, or the fed funds rate to rise much more quickly. Either would be a tall order, in our view.

ISM New Orders minus Inventories

Two components of the ISM Manufacturing Index, taken together, have a helpful track record of signaling recessions as they begin or shortly before. The difference between the New Orders component and the Inventories component has turned negative near the start of most U.S. recessions. But it has also registered occasional false positives, signaling that a recession was imminent when none subsequently arrived. Moreover, this indicator only relates to activity in the manufacturing sector (some 15% of the U.S. economy) and is derived from a survey rather than hard data. Therefore, we view this as a corroborative indicator—one to pay attention to if other, longer-term indicators are implying a recession is on the way. The spread between New Orders and Inventories has narrowed from its post-pandemic peak of a few months ago, but remains well above zero.

Stay committed to equities

We recommend global portfolios remain moderately Overweight equities. However, we recently reduced our recommended exposure to Europe to Market Weight from Overweight, acknowledging that the dislocations of the Ukraine war can be expected to take a toll on the EU economy.

REGIONAL
Equity

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United States

- The S&P 500 retreated notably in Q1, at one point falling 13.1% from peak to trough, due to concerns about inflation and accelerated Fed rate hikes, and risks associated with the Russia-Ukraine conflict and sanctions-induced commodity price pressures. However, the market clawed back much of its lost ground, ending the quarter down 5.0%.

- While we anticipate more volatility, we see scope for higher U.S. equity prices over the next year for a number of reasons: (1) domestic recession risks are still rather low, according to our leading economic indicators; (2) the U.S. economy is less vulnerable to the global supply chain and inflation shocks associated with sanctions on Russia because it is more self-sufficient and insular than the European economy; (3) S&P 500 earnings seem likely to grow at least moderately in 2022; (4) the S&P 500's forward price-to-earnings ratio is no longer as elevated, at 19.9x currently versus 21.5x at the beginning of the year; and (5) in our opinion, attractive fixed income investment opportunities are minimal, and holding cash is less appealing in an inflationary environment, both of which should support equity fund flows.

- Nevertheless, some fine-tuning of U.S. equity positions is warranted, in our view, because there is now a wider range of potential economic and earnings outcomes than there was just a few months ago. We think it's prudent for portfolios to include a greater share of stocks in defensive sectors—those that are less dependent on economic growth and are more resilient to inflation—including high-quality stocks represented by companies that have the potential to grow their dividends year after year.

Canada

- The Canadian equity market has been an area of relative strength for investors during what has proven to be a volatile start to 2022. The omicron variant, elevated inflation, and a tense geopolitical landscape are all concerns weighing on global markets. However, surging energy, base metal, and gold prices have supported the S&P/TSX Composite, as the Energy and Materials sectors account for roughly 30% of the index.

- Crude oil prices soared to heights not seen in several years as geopolitical risks contributed to an already supportive supply and demand backdrop. While oil has given back some of the geopolitical risk premium it enjoyed in March, we continue to expect prices to remain elevated, which supports our favorable outlook on the Canadian oil producers.

- The major Canadian banks wrapped up a solid Q1 2022 reporting season, with the group coming in ahead of consensus earnings expectations by an average of 10%. Management teams also sounded confident about the outlook, with expectations for expense growth to remain in check, credit quality to stay strong, and margins to improve as the interest rate hiking cycle continues through the year. Overall, we maintain a positive view on Canadian banks based on an expectation for improving loan growth and margins, reasonable valuations, and increased cash returns to shareholders.

Europe & UK

- We recently downgraded European equities to Market Weight from Overweight. The short-term outlook has become more complex owing to Russia's invasion of Ukraine. Elevated energy costs, extended supply chain disruptions, and reduced demand as the war dampens consumer spending will all dent the recovery in 2022.

- Still, we think the region offers compelling opportunities. Fiscal spending should underpin growth, and the MSCI Europe ex UK Index is now trading at 14.3x the forward consensus earnings estimate, a steeper-than-average discount to

REGIONAL EQUITY

the U.S. on a sector-neutral basis. In particular, we think stocks related to the green energy transition, which is now seen as a security issue rather than just an environmental matter, will benefit from this strong secular trend.

- We maintain our Market Weight in UK equities. While less directly impacted by the conflict than the EU, tighter monetary policy and fiscal headwinds challenge the country's outlook. However, on less than 12x forward earnings, we believe the FTSE All-Share Index offers value. Meanwhile, the index has a comparatively higher weighting in defensive and commodities stocks, while many multinational companies trade at steep discounts to their North American counterparts, which presents some attractive opportunities, in our view.

Asia Pacific

- China has set its GDP growth target at about 5.5% for 2022, which we think is aggressive, especially considering the current omicron outbreak and global growth uncertainties. However, historically China has taken its growth target seriously and implemented measures to meet or exceed it. To us, this means the government is likely to front-load some monetary and fiscal policies to support the economy. We think there is likely to be a cut to the reserve requirement ratio or the benchmark lending rate in the coming months.

- Government officials' recent statements regarding economic support, regulations on U.S.-listed Chinese firms, and regulatory reform have helped boost market sentiment. We believe investors would like more insight about the concrete measures associated with the statements before turning more bullish. Until this happens, the Chinese equity market could remain volatile in the short term.

- For Japan, we expect the omicron wave to subside in the coming weeks, leading to a recovery in consumer sentiment and retail sales. While rising inflation will continue to weigh on consumers' purchasing power, this should be mitigated by households' high savings rates and government subsidies. We expect GDP to contract in Q1 compared to the previous quarter, followed by a solid recovery in Q2 and further growth in Q3. The Bloomberg consensus forecast expects Japan's GDP to expand by 2.4% in 2022. Despite inflationary pressures, the Bank of Japan has no plans to change its policy stance. We have a positive view on Japanese equities over a short-term time horizon, as they usually outperform global equities when U.S. long-term interest rates and real interest rates are rising. But we are neutral over a medium-to-longer-term horizon given the lack of political stability.

GLOBAL

Fixed income

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Whatever it takes

Ramped-up rate hike expectations continue to rattle global bond markets, with the Bloomberg Global Aggregate Bond Index posting a decline of 5.9% through the first quarter of the year, its worst start in at least 30 years. Global yields have struggled to find a top, driving bond prices lower, as markets ponder how fast, and to what extent, major central banks will need to adjust interest rates in order to get inflation under control, all in the face of growing geopolitical and economic growth concerns.

In the U.S., Federal Reserve policymakers signaled the potential for seven rate hikes this year, which we now believe to be mostly priced into markets with the 10-year Treasury yield trading around 2.35% and the 30-year around 2.45%, both near the level at which we think the Fed will pause the rate hike cycle next year—2.50%. However, after a volatile start to the year for bond markets, there may be little rest for the weary as we expect the Fed to formally announce plans to shrink its balance sheet at the May 3–4 policy meeting.

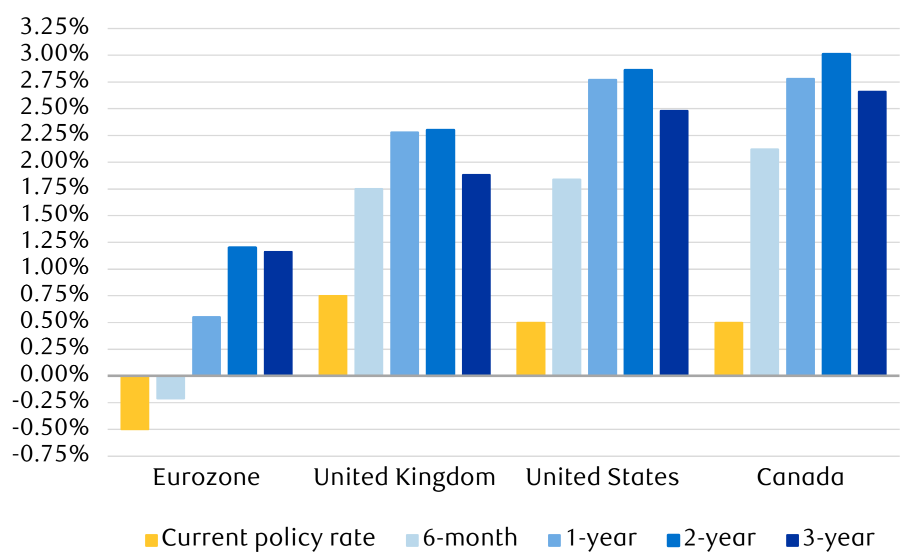
Fixed income views

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

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

But the biggest impact of all of these policy developments has been sharply flatter sovereign yield curves, particularly in the U.S. and Canada, where certain key segments of curves are on the cusp of inversion—a historical sign of rising recession risks. One such benchmark curve, the spread between 10-year and 2-year Treasury yields in the U.S., has inverted for the first time since 2019 trading at a -0.05% level. We think it's nearly inevitable that it inverts on a sustained basis at some point

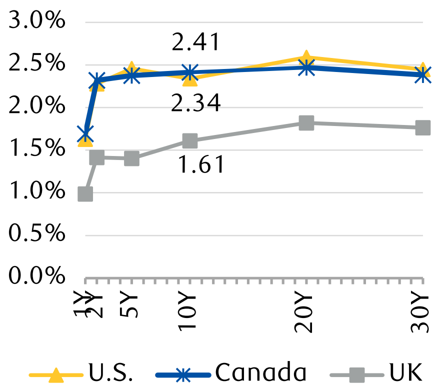
Central bank policy rates and market expectations for the path forward



Source - RBC Wealth Management, Bloomberg; market pricing based on overnight index swap rates; data as of 3/28/22

GLOBAL FIXED INCOME

Sovereign yield curves



Source - Bloomberg; data through 3/31/22

in the coming months—but that its recession signal will be slightly weaker this cycle; we will look for deeper inversions below -50 basis points for recession signals.

Demand for Treasuries from foreign investors and pension plans as well as general safe-asset demand could help to keep a cap on longer-term Treasury yields, even as the Fed aggressively raises short-term rates—all of which are technical factors, not economic ones—that could heighten the chances of inversion this business cycle. Beyond that, we believe it will likely take at least a year for the Fed to raise its policy rate to a level that could potentially restrict economic activity, a level the Fed currently estimates to be 2.40%. We continue to think that yield curves will dominate financial market headlines this year, but that near-term recession risks ultimately remain low.

REGIONAL HIGHLIGHTS

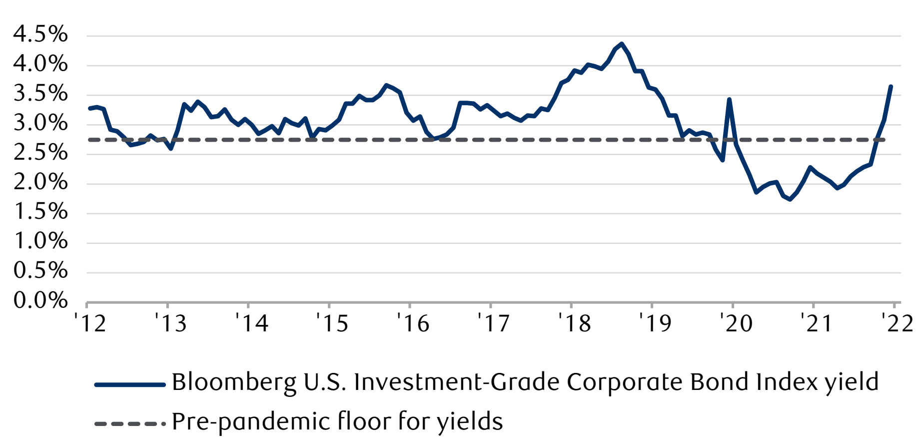
United States

- The Federal Reserve signaled seven 25 basis point rate hikes this year, according to its updated interest rate projections from the March meeting, which would bring the policy rate to a 1.75%–2.00% target range. While that's an aggressive pace compared to the past (2015–2018) cycle, market-based pricing suggests traders see a chance the Fed will actually raise rates to a target range as high as 2.25%–2.50% in 2022.

- Bond market volatility has increased sharply as the market reprices the Fed's rate hike path. But the question of how high rates may need to go just to get inflation under control is also causing anxiety. As it stands, markets envision the Fed raising rates to about 2.75% before pausing. It's this level that will likely dictate how high Treasury yields can theoretically go, in our view, with the 10-year and 30-year Treasury yields ending March at 2.34% and 2.45%, respectively.

- Despite Fed policy tightening, flattening yield curves, and very modest—but rising—recession risks, we maintain an Overweight allocation to credit on a 12-month horizon. We remain Underweight government debt and are Neutral regarding yield curve positioning, but after the backup in Treasury yields we see opportunity to extend maturities both for the attractive yields, and for the portfolio ballast longer-dated securities could provide should economic and/or market risks continue to rise.

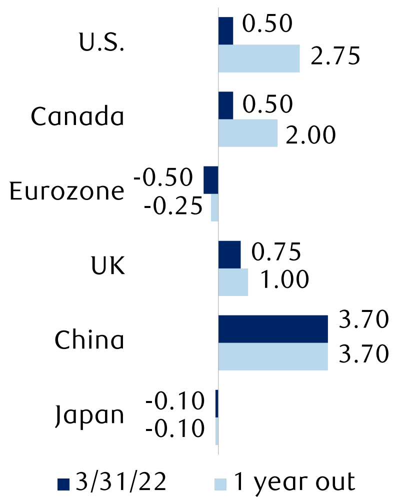
U.S. corporate bond yields recover from pandemic lows, offering most attractive yield in years



Source - RBC Wealth Management, Bloomberg; data through 3/29/22

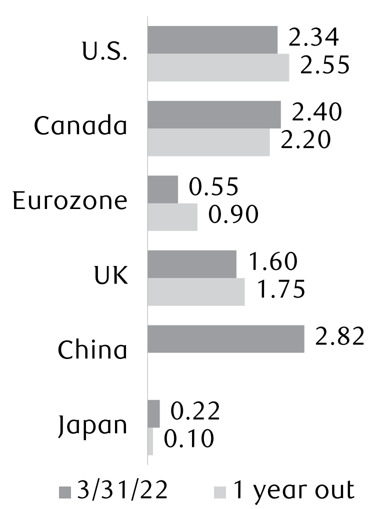
GLOBAL FIXED INCOME

Central bank rate (%)



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

10-year rate (%)



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

Canada

- The month of March marked the beginning of the Bank of Canada's (BoC's) monetary tightening cycle. The BoC delivered the first of a number of policy rate hikes expected for 2022. Additional inflationary pressures brought on by the Russia-Ukraine war have exacerbated the case for tighter policy. At 5.7% y/y, February marked the 11th consecutive month that inflation exceeded the BoC's 1% to 3% target range, and the highest inflation any Canadian under the age of 30 has ever seen.

- Bond yields rose sharply in Q1 2022, as markets priced in the impact of the new tightening cycle. Despite the path towards higher rates being painful for existing fixed income holdings, the final destination is ultimately a good one for income-oriented investors, in our view. We continue to see good value in high-quality short-term bonds. Decisions to extend duration much further from here will be guided by evolving views around inflation and economic growth, and lingering uncertainty on these fronts leaves us cautious at present.

- Along with the expectation of a less accommodative BoC, escalating geopolitical tensions have introduced a new layer of uncertainty for risk assets. Yield compensation for assuming the credit risk inherent in corporate bonds has increased, with spreads at some of their widest levels since 2020. In our opinion, this makes the case for corporate credit much more compelling today than in previous quarters.

Europe & UK

- The Bank of England (BoE) is raising rates, while acknowledging the income squeeze UK households are facing. The European Central Bank (ECB), meanwhile, is withdrawing stimulus sooner than had been widely expected through an accelerated exit from its asset purchase programme. ECB President Christine Lagarde described the bank's recent decision as laying the foundation for rate lift-off and moving "towards policy normalisation" while expressing caution, echoing similar concerns from the BoE. At a recent conference, Lagarde and ECB Chief Economist Philip Lane hinted at the possibility of raising rates in December.

- UK inflation soared to 6.2% y/y in February. The BoE now expects inflation to rise to "around 8%" in Q2 and estimates it could be "several percentage points higher" by October than the 7.25% it forecasted in February. The ECB's March staff forecasts are lower, with a baseline scenario of inflation reaching 5.1% in 2022 and a severe scenario of 7.1% inflation this year.

- The UK Government's Spring Statement contained a surprise announcement on Treasury issuance which could fall heavily into the next fiscal year, thus supporting bond prices and flattening yield curves in the near term. In our view, the market's current rate hike expectations and pace are too elevated, as we expect the BoE to pause once the Bank Rate reaches 1% in order to assess the effect of monetary tightening on households. In the euro area, we favour German Bunds over Italian bonds as we think the end of the ECB's purchase program will have a more unfavourable effect on the latter. We prefer to allocate to higher-quality corporate credit across both markets, as we see potential for credit spreads to widen in the near term.

Asia Pacific

- Asian credit spreads have widened since Russia invaded Ukraine. In particular, within the investment-grade universe, the China technology sector was hit alongside the selloff of China tech ADRs due to renewed concerns over the possible delisting of these companies from U.S. markets.

- Meanwhile, China high-yield bonds also continue to be under pressure, with more defaults as market fundamentals have failed to improve.

GLOBAL FIXED INCOME

Property sales slumped between -24% to -48% for the first two months of 2022, according to the China Real Estate Information Corp. While privately owned companies were the ones whose revenues suffered the most last year, some of the largest state-owned property developers are beginning to share the pain, with sales down as much as 40% to 50% in the first two months of the year.

- To address these issues, the Chinese State Council's Financial Stability and Development Committee, chaired by Vice Premier Liu He, vouched on March 16 to keep the stock market stable and the economy operating at a "reasonable" level. Specifically, the council is looking to support overseas share listings, i.e., ADRs. The council also mentioned that it will adopt "strong and effective" policies to handle property developers' risks. Since then, markets have partially recovered, but we believe concrete follow-through measures will be needed before a full recovery can occur.

Commodities

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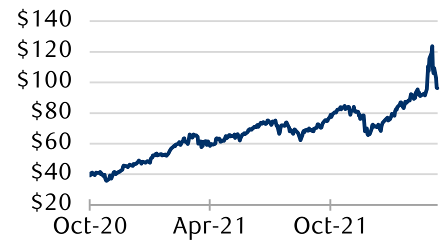
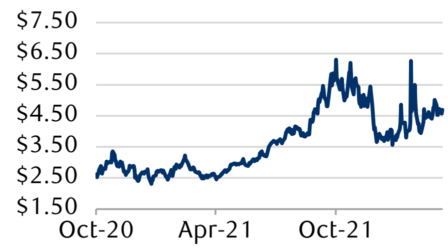
Crude oil: Geopolitics

Global oil prices advanced materially higher year to date but retraced off their highs since the onset of the Russia-Ukraine crisis. Russia accounts for roughly 11% of global production and acts as a vital source of supply for European nations. In relation to the invasion of Ukraine, the U.S. has since banned the import of Russian oil alongside refined products.



Natural gas: Less dependence

In an effort to reduce its exposure to Russian natural gas, the EU proposed measures to diversify its supplier base and accelerate investments into renewables, along with plans to become more energy efficient. RBC Capital Markets believes this will ultimately drive a tighter global marketplace although U.S. pricing should be more insulated on a relative basis.



Copper: Low inventory

The invasion of Ukraine alongside the latest COVID-19 outbreak in China has caused copper to retrace from its 18-month highs. Global inventories remain at historically low levels and, as such, RBC Capital Markets believes prices will remain elevated in H1 2022 before supply starts to normalize in the second half of the year. The medium-term setup remains favourable, underpinned by the energy transition.

Gold: Higher

A maturing business cycle in conjunction with increased recessionary risks pushed gold to its highest levels since August 2020. Furthermore, escalating global supply chain issues will likely support persistently high inflation which, in theory, should be supportive for gold. However, we believe the Federal Reserve's hawkish stance remains a critical offset for meaningfully higher prices outside of an uptick in geopolitical risks.

Soybeans: Soaring

The combination of elevated geopolitical risk and unfavourable weather conditions in South America pushed soybean prices to $17 per bushel, its highest level since 2012. Imports going into China also increased modestly year over year. The USDA adjusted its global trade and ending inventories forecasts lower for the 2021–2022 season.

Wheat: Surging

Global wheat prices surged following the start of the Russia-Ukraine conflict given the two nations account for approximately 14% of global production in aggregate. We note that prices were already elevated, driven by tight supplies in major exporting nations. RBC Capital Markets estimates stock-to-use will decline to 32% from 35% in the 2022–2023 season.

Commodity forecasts

Commodity	2022E	2023E
Oil (WTI $/bbl)	$98.30	$96.29
Natural gas ($/mmBtu)	$3.85	$3.45
Gold ($/oz)	$1696	$1650
Copper ($/lb)	$4.25	$3.75
Soybeans ($/bu)	$13.03	$12.33
Wheat ($/bu)	$8.00	$7.68

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

Chart source - RBC Wealth Management, Bloomberg; date range: 10/5/20–3/16/22

Currencies

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Currency forecasts

Currency pair	Current rate	Forecast Mar. 2023	Change
Major currencies			
USD Index	97.74	101.68	4%
CAD/USD	0.80	0.78	-2%
USD/CAD	1.24	1.28	3%
EUR/USD	1.11	1.07	-4%
GBP/USD	1.31	1.18	-10%
USD/CHF	1.02	0.99	-3%
USD/JPY	121.95	118.0	-3%
AUD/USD	0.75	0.67	-11
NZD/USD	0.69	0.71	3%
EUR/JPY	136.12	126.0	-7%
EUR/GBP	0.84	0.91	8%
EUR/CHF	1.02	1.06	4%
Emerging currencies			
USD/CNY	6.34	6.32	0%
USD/INR	75.90	74.50	-2%
USD/SGD	1.35	1.34	-1%

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

Source - RBC Capital Markets forecasts, Bloomberg

U.S. dollar: Fed hikes 25 basis points

The Federal Reserve weighed the uncertainties from geopolitical events in Ukraine and opted for a less aggressive rate hike in March, despite surging inflation in the United States. A hawkish projection of six more rate hikes in 2022 was already priced in by investors and did not move the U.S. dollar much, but we expect the greenback to remain firm in a rising U.S. yield environment.

Euro: Under pressure from the war in Ukraine

The European Central Bank had a hawkish tilt in March by announcing that it may phase out its stimulus program earlier than expected in Q3, but the guidance that rate hikes would follow "shortly" was removed. Europe's reliance on commodity imports and soaring energy costs from sanctions on Russia should translate into weaker European growth and a lower euro.

Canadian dollar: Supported by higher commodity prices

The Bank of Canada raised interest rates to 0.5% in March, and more rate hikes are expected this year following a strong set of economic data in Canada. The rise in oil prices from the Russia-Ukraine conflict is also supporting the loonie, with RBC Capital Markets economists maintaining a target of 1.27 on the USD/CAD through 2022.

British pound: Stagflation risks ahead

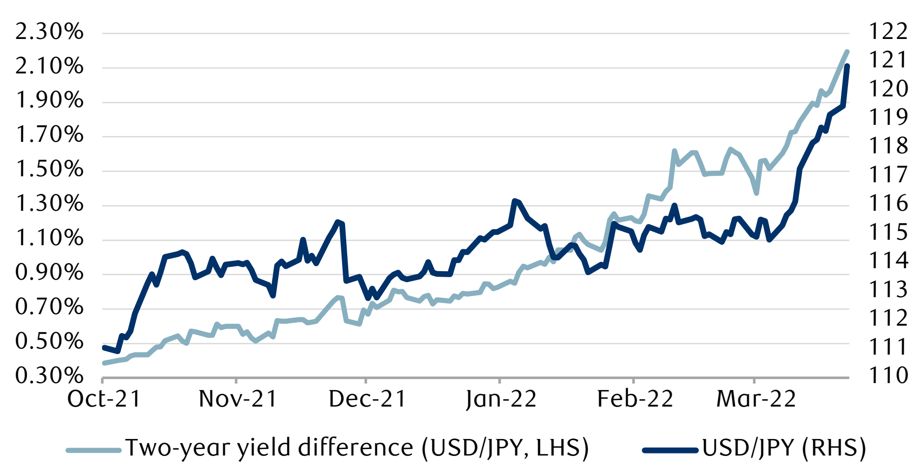
Rising inflation expectations and a weaker growth outlook in the UK increase the risk of stagflation, which could weigh on the pound. The Bank of England has already hiked rates three times since December, bringing the Bank Rate to a pre-pandemic 0.75% level. RBC Capital Markets economists expect one more rate hike this year and project the Bank Rate to be 1% by the end of 2022, much lower than the 2% currently priced in by investors.

Japanese yen: BoJ remains dovish

The Bank of Japan refused to join the wave of global central banks in normalizing monetary policy and instead pledged to continue stimulus even if inflation reaches 2% in Japan. We expect the yen to underperform as monetary policy divergence favors higher-yielding currencies.

USD/JPY reached a six-year high as the Fed hiked rates and signaled there were more to come, while the BoJ remained in the dovish camp

USD/JPY pair has been sensitive to short-term yield differences between the two currencies



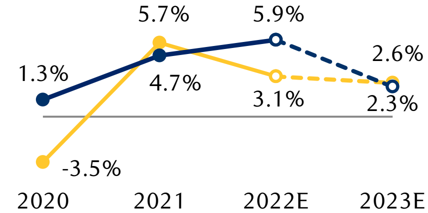
Source - RBC Wealth Management, Bloomberg; data through 3/22/22

KEY
Forecasts

Real GDP growth   Inflation rate

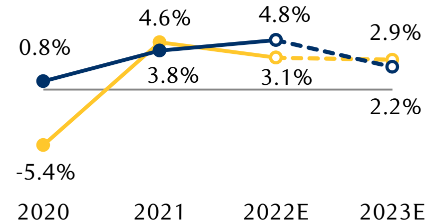
United States: Spending shifts to services

Consumer outlays firm, but rising fuel costs pre-empting other spending. Inventory boost to Q4 GDP likely to be paid back in slower Q1. New orders weaker as spending shifts to services from goods. Omicron case counts and inflation are headwinds for the consumer. Employment picture robust. Corporate guidance citing labour shortages and inflation as issues. Fed tightening to dampen growth starting late in the year. Goods inflation should weaken along with new orders.



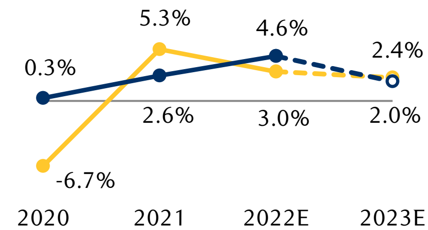
Canada: Consumer squeeze

January GDP managed to grow despite omicron-related shutdowns. Reopening is boosting services spending and employment. Back-to-the-office plans widespread among major employers including government. Capex looks set to pick up aided by a recovery in the Energy sector. Bank of Canada likely to follow the Fed tightening path. Inflation and rate hikes could tighten consumer discretionary spending capability.



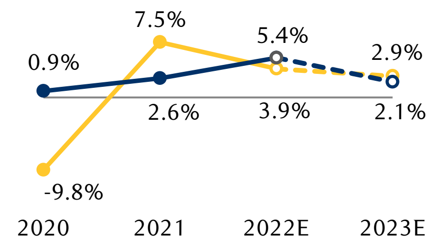
Eurozone: Military spending increase ahead

After a strong Q4, despite weak German results, Q1 has seen sentiment sag close to pandemic levels. PMIs have weakened and factory output declined modestly. Manufacturing and services PMIs are down but still in expansionary territory. Russia's invasion of Ukraine has dampened household spending intentions and put any ECB tightening on hold. Military spending set to boom. We forecast a weaker-than-expected year but short of recession.



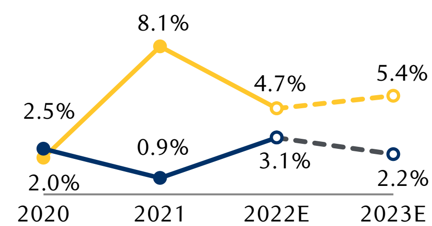
UK: BoE tightening

Consumer and business confidence have both weakened as have retail sales. Services PMI has receded slightly but remains elevated. The recent resurgence of COVID-19 cases and hospitalizations could threaten the services recovery including tourism. Employment solid, construction and new orders steady. Inflation still advancing, now at 6.2%. The BoE delivered a third rate hike in March and is expected to pause until later in the year.



China: Policy boost expected

GDP growth under renewed pressure as variant-related shutdowns are hitting major sectors. PMIs have sagged, adding to property sector woes and supply chain disruptions. Higher commodity prices are hurting profit margins and the consumer. Government's expected growth rate of 5.5% implies some major policy support will be forthcoming soon. Easing has produced some revival in credit growth, but we look for reserve requirement ratio and/or interest rate cuts in coming months.



Japan: Better tone emerging

Weak exports and industrial production in January along with a COVID-19 surge have likely produced a negative Q1. Supply chain/shipping disruptions easing somewhat. Exports rebounded in February, setting up a Q2 recovery. Inflation far milder than most other economies. COVID-19 cases receding quickly. An improved vaccine program holds hope for a consumer spending revival in Q2. Capex subdued. The BoJ is expected to stay on hold.

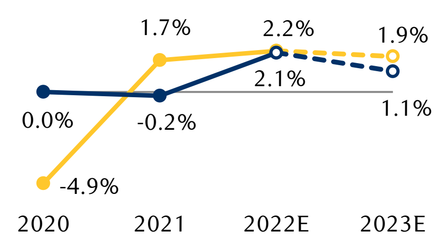


Chart source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management, Bloomberg consensus estimates

MARKET Scorecard

Data as of March 31, 2022

Equities

Global equity markets were mixed for the month while year-to-date performance remains pressured amid geopolitical concerns.

Bond yields

Sovereign bonds weakened on rising inflation fears and the first of several recent interest rate bumps by the U.S. Federal Reserve.

Commodities

World commodity prices rose across the board, with oil and natural gas surging on expectations of reduced supply.

Currencies

The U.S. dollar lost ground against most major currencies but managed to strengthen versus the Japanese yen.

Index (local currency)	Level	1 month	YTD	12 month
S&P 500	4,621.14	5.7%	-3.0%	16.3%
Dow Industrials (DJIA)	35,271.80	4.1%	-2.9%	6.9%
Nasdaq	14,532.72	5.7%	-7.1%	9.7%
Russell 2000	2,127.68	3.9%	-5.2%	-4.2%
S&P/TSX Comp	22,067.50	4.5%	4.0%	18.0%
FTSE All-Share	4,210.01	1.3%	0.0%	9.9%
STOXX Europe 600	459.79	1.5%	-5.7%	7.0%
EURO STOXX 50	3,956.91	0.8%	-7.9%	1.0%
Hang Seng	22,232.03	-2.1%	-5.0%	-21.7%
Shanghai Comp	3,266.60	-5.7%	-10.3%	-5.1%
Nikkei 225	28,027.25	5.7%	-2.7%	-3.9%
India Sensex	58,683.99	4.3%	0.7%	18.5%
Singapore Straits Times	3,442.61	6.2%	10.2%	8.8%
Brazil Ibovespa	120,211.38	6.2%	14.7%	3.1%
Mexican Bolsa IPC	56,031.23	4.9%	5.2%	18.6%
Bond yields	**3/30/22**	**2/28/22**	**3/31/21**	**12 mo. chg**
U.S. 2-Yr Tsy	2.341%	1.432%	0.160%	2.18%
U.S. 10-Yr Tsy	2.363%	1.825%	1.740%	0.62%
Canada 2-Yr	2.318%	1.435%	0.226%	2.09%
Canada 10-Yr	2.460%	1.813%	1.558%	0.90%
UK 2-Yr	1.380%	1.039%	0.104%	1.28%
UK 10-Yr	1.666%	1.410%	0.845%	0.82%
Germany 2-Yr	0.032%	-0.601%	-0.691%	0.72%
Germany 10-Yr	0.664%	-0.185%	-0.292%	0.96%
Commodities (USD)	**Price**	**1 month**	**YTD**	**12 month**
Gold (spot $/oz)	1,937.60	1.5%	5.9%	13.5%
Silver (spot $/oz)	25.06	2.5%	7.5%	2.6%
Copper ($/metric ton)	10,314.50	4.0%	5.9%	17.4%
Oil (WTI spot/bbl)	108.24	13.1%	40.6%	83.0%
Oil (Brent spot/bbl)	114.24	13.1%	46.9%	79.8%
Natural Gas ($/mmBtu)	5.55	26.0%	48.7%	112.7%
Agriculture Index	537.62	3.6%	20.8%	39.5%
Currencies	**Rate**	**1 month**	**YTD**	**12 month**
U.S. Dollar Index	97.7450	1.1%	2.2%	4.8%
CAD/USD	0.8029	1.7%	1.5%	0.9%
USD/CAD	1.2456	-1.7%	-1.4%	-0.8%
EUR/USD	1.1162	-0.5%	-1.8%	-4.8%
GBP/USD	1.3171	-1.9%	-2.7%	-4.4%
AUD/USD	0.7517	3.5%	3.5%	-1.1%
USD/JPY	121.9500	6.0%	6.0%	10.1%
EUR/JPY	136.1200	5.5%	4.0%	4.8%
EUR/GBP	0.8475	1.4%	0.7%	-0.4%
EUR/CHF	1.0295	0.1%	-0.8%	-7.0%
USD/SGD	1.3528	-0.2%	0.3%	0.6%
USD/CNY	6.3475	0.6%	-0.1%	-3.1%
USD/MXN	19.8555	-3.0%	-3.3%	-2.8%
USD/BRL	4.7687	-7.4%	-14.5%	-15.4%

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 0.80 means 1 Canadian dollar will buy 0.80 U.S. dollar. CAD/USD 0.9% return means the Canadian dollar has risen 0.9% vs. the U.S. dollar during the past 12 months. USD/JPY 121.95 means 1 U.S. dollar will buy 121.95 yen. USD/JPY 10.1% return means the U.S. dollar has risen 10.1% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 3/31/22

Research resources

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As of March 31, 2022

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