

Special report



Wealth  
Management

# GLOBAL Insight 2021 Midyear Outlook

As the recovery's momentum builds, what does a normalizing global economy hold in store for financial markets?



For important and required non-U.S. analyst disclosures, see page 18.  
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As we enter H2 2021, all signs point to a continued economic improvement and no recession in the immediate future. Although a correction is always possible, we don't view one as inevitable.

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The prospect of the Federal Reserve tightening monetary policy has swung back into view, prompting market volatility and raising concerns about support for the global recovery. Will the Fed's policy moves encourage global central banks to follow suit?

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GLOBAL  
Equity



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# Green light for economy and markets

In our view, nothing that has transpired in the past six months has fundamentally changed our outlook for the remainder of 2021 or for 2022. We expect all of the developed economies, led by the U.S., will post above-average GDP growth compared to last year’s slump. Absent a vigorous return of the pandemic, the momentum provided by repeated applications of fiscal stimulus from governments—supported by entrenched accommodative monetary policies—should keep most economies powering on through next year and probably beyond. Robust growth this year followed by slower, but still above-average growth next year looks to be the likely outcome.

For the all-important U.S. economy, this view is supported by our economic recession scorecard. All six of the leading indicators of recession we track are giving the economy a decisive green light, and are strong enough to suggest that even an “early warning” phase lies a long way off.

Looking at just one of these indicators, we note that the fed funds rate has almost always risen above the nominal growth rate of

the economy (i.e., the rate before adjusting for inflation) before a recession gets underway. The year-over-year nominal growth rate of the U.S. economy was 2.7% as of Q1, is rising sharply, and should be in the 9% neighbourhood by year end, slowing to 6% by the end of 2022. In order for the fed funds rate to rise above that 6% level, and risk inducing a recession, the Fed would need to raise rates a by one-quarter point 24 times—a nearly inconceivable scenario, in our view, especially because the Fed sees no rate increases before 2023.

In our view, the next recession, when it eventually arrives, will likely be triggered the good old-fashioned way—by a tightening of credit conditions sufficient to make interest rates prohibitively expensive and banks more cautious about lending. However, no tightening of that magnitude appears nearby.

### No recession on the horizon

Recessions are the enemy of the equity investor, as they have always formed the economic backdrop associated with bear markets. So

### U.S. recession scorecard

Indicator	Status		
	Expansion	Neutral	Recessionary
Yield curve (10-year to 1-year Treasuries)	✓		
Unemployment claims	✓		
Unemployment rate	✓		
Conference Board Leading Index	✓		
ISM New Orders minus Inventories	✓		
Fed funds rate vs. nominal GDP growth	✓		

Source - RBC Wealth Management

## GLOBAL EQUITY

seeing a recession coming ahead of time is extremely useful from a portfolio-management perspective. We believe, as yet, and probably for some time, no recession appears on the horizon.

While a bear market-inducing recession may not be in the offing anytime soon, there is always the potential for fears arising from a growth slowdown to induce a market correction. In several bull markets over the past 70 years, such worries have led to a correction 12–18 months after the start of the new economic advance. However, these were always eventually superseded by another substantial leg up for the economy, corporate profits, and the equity market.

### History lessons

Another way to plot the path ahead is suggested by Eric Savoie, investment strategist at RBC Global Asset Management Inc. He points out that in the U.S. there have been 17 Federal Reserve tightening cycles since 1954, with eight of them producing enough credit tightening to bring on a recession.

Looking at equity market performance over the 12 months leading up to the first Fed rate hike

in each cycle, Savoie notes that the median return for the S&P 500 over that stretch was 16.8%. Switching to look at what the market does in the year *after* the first rate hike reveals a median return of an above-average 9%.

So, the year before the first rate hike and the year after are both generally pretty good for the stock market. If the Fed tightening cycle is going to cause trouble for the stock market, that trouble usually arrives a ways down the road from the first rate hike, if it arrives at all, keeping in mind that nine Fed tightening cycles produced no recession or any equity bear market.

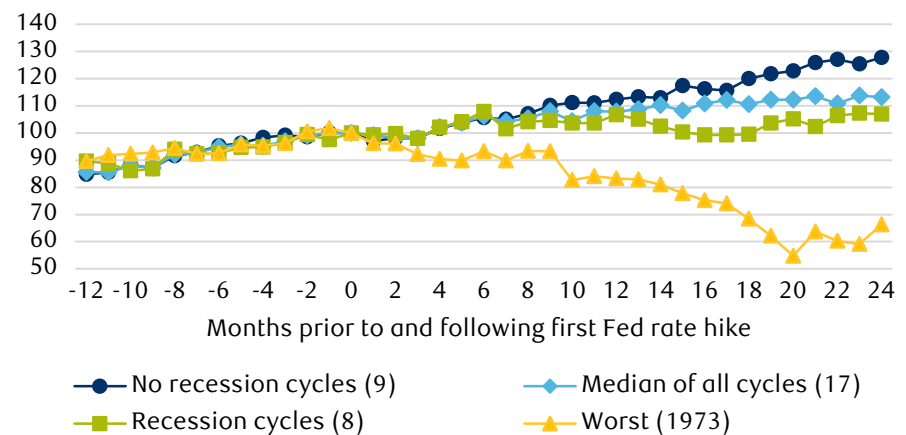
The Fed, while always reserving the right to change its mind, has told us there will be no rate hike before early 2023. Counting backward one year, the historical probabilities would suggest the stock market will deliver positive, probably above-average returns for two consecutive years starting in early 2022.

### Correction always possible, but not a given

Of course, even years that feature above-average stock market returns can contain within them rocky periods of correction and

### Don't fear the rate hike; stocks can still rally as long as hikes don't trigger recessions

Median S&P 500 level before and after first rate hike  
Normalized, with level at first hike = 100



Source - RBC Global Asset Management, RBC Wealth Management; data range: 1954-2018

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## GLOBAL EQUITY

consolidation. It's always possible that one lies just around the corner. As usual, there is a long list of things investors are worried about, including inflation, the pandemic, geopolitics, and severe weather (ranging from heavy rains to drought conditions). In one sense, investors are right to expect a correction, because they are not uncommon. But they rarely announce their arrival (or conclusion) in a timely enough fashion to allow even a nimble investor to wring much advantage out of that knowledge.

There are also plenty of factors that would argue against a correction occurring:

- Most economies are reopening as the vaccine rollout diminishes the impact of the pandemic;
- Earnings are very strong (GDP-based U.S. corporate profits are already above their pre-pandemic peak) and forward-year earnings estimates have been revised sharply higher over the past six months (S&P 500 by 15% and TSX by 13%);
- CEO confidence, as measured by The Conference Board, is near an 18-year high, while business confidence is high and rising in

Germany, France, and Canada, and improving in the UK and Japan;

- Corporate bond yields remain very low and access to credit plentiful; and
- Capital spending is extremely strong, which is good news for productivity and inflation.

It's worth remembering that should a market correction occur without an accompanying downturn in economic activity and corporate profits, then even though share prices are falling for a few months, the intrinsic, underlying value of most businesses goes on compounding upward at a rate driven by earnings growth.

### Global equities likely to advance

We are left with a constructive outlook for global equities for the coming 12 months. We expect the impact of the pandemic will continue to subside over the remainder of this year and through 2022. The forecast rising tide of GDP and earnings should permit broad market indexes to advance further from today's levels. We recommend a global balanced portfolio remain moderately Overweight equities.

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## United States

■ The S&P 500's 90% surge from the deep COVID-19 crisis lows of March 2020 through late-June is the strongest post-trough rally of all recovery periods that took place during similar time frames going back to the 1960s. Now we think the market is entering a transition period—from that of a robust rally phase to a two steps forward, one step back phase that commonly transpires when economic recoveries come off of their initial boil.

■ With the market's "easy" gains likely in the rearview mirror, we think four interrelated issues will set the tone in the second half of this year and into 2022: (1) inflation rates easing down from high to less lofty levels, but remaining above-average; (2) the progression toward less accommodative Fed policies with the start of the central bank's tapering of asset purchases; (3) continued above-trend GDP growth, but at a slower pace; and (4) the shift from ultra-high earnings growth to more normal growth rates.

■ Uncertainties or periodic data contradictions related to any one of these issues could create market volatility or pullbacks, but we think all four are manageable and will not hinder worthwhile market gains over the next six to 12 months. The earnings transition will come into

focus sooner rather than later, as we think the upcoming Q2 2021 reporting season will represent "peak growth," or the high water mark of year-over-year earnings growth for this business cycle. But by no means do we think it will mark the peak absolute level of the S&P 500 earnings—profits should march higher over the next year, at least. We would continue to hold modestly Overweight positions in U.S. equities and still favor value sectors.

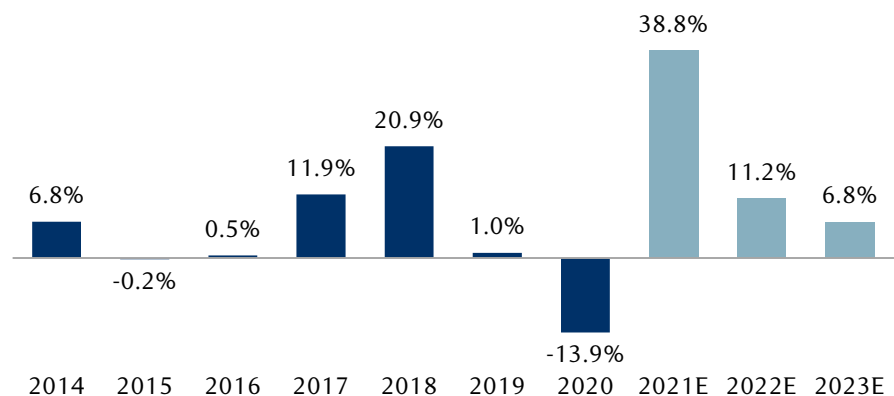
## Canada

■ Amidst recovery from last year's recession, we expect above-trend economic growth to disproportionately benefit the traditionally economically-sensitive (cyclical) sectors within equity markets. This view supports a constructive stance towards the Canadian market given its cyclical orientation including large benchmark weights in Financials (31%), Materials (13%), and Energy (12%). Moreover, the S&P/TSX Composite continues to trade at a significant discount relative to the S&P 500. Discounts of similar magnitude have historically resulted in positive relative returns for the Canadian equity market.

■ We maintain a positive view on Canadian banks in a benign credit environment. Last year's provisions

## U.S. earnings growth rate forecast to peak in 2021

S&P 500 earnings growth y/y % change, 2021–2023 data is consensus estimate



## REGIONAL EQUITY

### Equity views

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

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

for potential loan losses appear to have been overly conservative in the wake of massive government support and the ensuing rapid economic recovery. We believe investor focus over the next year will be on improving consumer loan growth and margin trends as the domestic vaccination campaign advances further, arguably justifying greater liberalization of virus containment measures.

■ WTI crude oil prices topped US\$70 per barrel in June. The rise has outpaced RBC Capital Markets' already bullish view on the commodity heading into 2021, resulting in an increase in its forecast for average prices to US\$72.27 per barrel in 2022 from US\$63 per barrel previously. We believe that valuations for Canadian oil producers, particularly those with integrated operations, remain attractive given their impressive free cash flow generation potential amid a supportive commodity price backdrop.

■ The key risks to the thesis on Canadian equities include, but are not limited to, the potential for a fourth COVID-19 wave on the back of increasing variant cases and/or slowdown in vaccinations, an appreciating U.S. dollar in the context of its potentially negative impact on commodity prices, and a greater-than-expected slowdown in the Canadian real estate market.

### Europe & UK

■ We recently upgraded European equities to Overweight, suggesting investors have an above benchmark position in the region. The European Commission's efforts towards debt mutualisation—or sharing—via the €750 billion rescue package and the issuance of EU bonds to support the recovery should reduce systemic risk for the region.

■ Beyond this, the economy is predictably bouncing back after a long winter of lockdowns. The ECB's commitment to a continued loose

monetary policy even as the Fed moves toward tapering its bond-buying program in early 2022 will likely cap gains in the euro currency, providing a tailwind to corporate earnings. Moreover, European equities typically outperform when economic activity is improving due to their comparatively high exposure to economically-sensitive (cyclical) sectors such as Financials, Industrials, Consumer Discretionary, and Materials.

■ The MSCI Europe ex UK Index trades at a more than 20% discount to the S&P 500, but comes roughly in line with it on a sector-adjusted basis. We continue to favour the Industrials and Consumer Discretionary sectors as we believe they are well-positioned to benefit from both an improving global economy and long-term secular trends.

■ The UK is also enjoying a robust economic rebound as the bulk of COVID-19 restrictions are being lifted. We advocate a Market Weight, or up to benchmark, position in UK equities. The FTSE All-Share's price-to-earnings valuation is relatively cheap versus its historical average, and the index offers a dividend yield of over 3%. In the medium term, UK economic growth might be capped by a chancellor eager to balance the nation's books, and increasing tensions with the EU in regards to the Northern Ireland protocol, a consequence of the Brexit deal passed by the UK parliament.

■ We would take a balanced approach to UK equities by maintaining exposure to quality UK international companies that trade at what we perceive as an unduly large valuation discount to overseas-listed peers; and by holding positions in the beneficiaries of a domestic economic recovery, such as Financials and consumer-focused domestic stocks, the latter of which are underpinned by pent-up demand meeting high levels of consumer savings.

## REGIONAL EQUITY

### Asia-Pacific

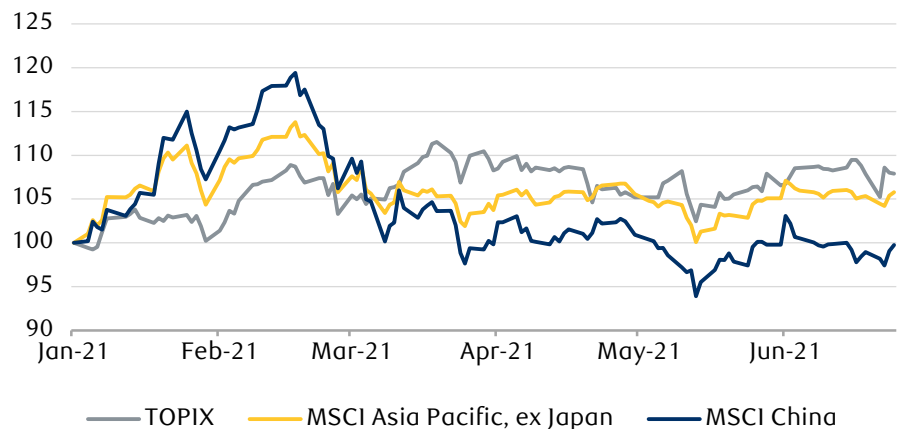
- We expect China equities to stay largely range-bound in H2 2021. Policy normalization could cap market upside in the near term as, historically, equity uptrends usually have been accompanied by credit easing cycles. We expect broad credit growth will continue to slow down in Q3 2021 and may stabilize in Q4. Tensions in U.S.-China relations, tighter-than-expected policy moves by authorities, and/or news related to antitrust investigations could add volatility to the market.
- Company earnings reports are likely to remain solid, which should provide downside support for the market. Sentiment may improve as the H1 2021 earnings season approaches. For the second half of the year, we expect MSCI China to report high-teens earnings growth.
- Despite some short-term headwinds, we remain constructive on China equities as we see attractive longer-term secular opportunities that should coincide with the economic reopening and

transition. We prefer quality value stocks such as leading banks and industrial companies. We also like leading consumer staples players and recovery beneficiaries. In addition, we think this is a good opportunity to accumulate quality new economy stocks.

- Japan equities underperformed developed markets in Q2. In the near term, we believe the market could play catch-up as economic activity rebounds on the back of faster vaccination rates. Also, valuations are less stretched than before, earnings revisions remain in positive territory, and we see scope for upside surprises to forward earnings estimates. But for a time frame beyond three months, we think Japan equities could be stuck in a range as growth in the global money supply starts to slow as central banks' monetary easing gradually loses momentum, which could lead to a higher risk premium for Japanese stocks. Meanwhile, USD/JPY movement may also dampen foreign investors' appetite.

### Asian equity markets, year to date

Performance indexed to 100



Source - RBC Wealth Management, FactSet; data through 6/25/21



GLOBAL  
Fixed income



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# The event horizon

Once beyond view for investors, the prospect of the Federal Reserve tightening monetary policy has now swung back across the market’s event horizon and into the observable universe, reintroducing volatility to markets and raising concerns about central bank support for the global economic recovery. On top of that, will the Fed’s looming policy moves set the stage for other global central banks to follow suit?

projection of the 18 members of the Federal Open Market Committee (FOMC) now indicating the potential for two rate hikes in 2023, up from zero previously. Markets took those two developments together as a sign Fed policymakers may see inflationary pressures as likely to prove more persistent than they had previously let on. Not surprisingly, the unexpectedly hawkish signals from the meeting reintroduced some volatility into the market.

## Summer surprise

At the halfway point of the year, the Fed’s June meeting marked a pivotal point for policymakers as they began formal discussion of plans to taper asset purchases. Progress toward employment and inflation goals appears to be sufficient for the Fed to begin entertaining the idea of pulling back on the policy reins following the historic policy response to the global pandemic.

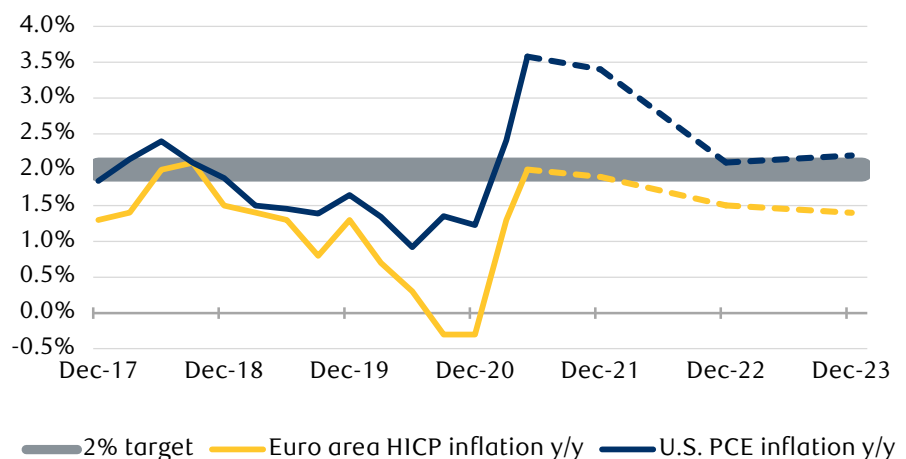
We think that volatility will be a lasting feature during the back half of the year, with markets likely to enter into a game of “will they, won’t they” as they digest the Fed’s response to each incoming data point on inflation and the labor market.

While the onset of the tapering process had been generally expected to occur at some point this summer, what was less expected was that it would be paired with a faster rate hike forecast, with the median

That’s because the Fed has set some lofty goals in its effort to achieve “substantial further progress” on its inflation and employment targets. As of the June meeting, the Fed’s projections are looking for an unemployment rate of 4.5% by year’s end, from 5.8% currently, and for headline PCE inflation to still be running at a 3.4% clip, roughly unchanged from the 3.6% year-over-

## Central bank projections continue to show temporary inflationary pressures

U.S. PCE inflation y/y and euro area HICP inflation y/y



Note: Dashed lines show central bank median forecasts  
Source - RBC Wealth Management, Bloomberg, Federal Reserve, European Central Bank

## GLOBAL FIXED INCOME

year pace in the latest data from April. That's a high bar, in our view, so it's equally conceivable that recent hawkishness could turn back to dovishness should the data not keep pace with expectations.

In any event, we still expect the Fed to unveil a formal tapering plan in August or September, and to begin cutting its monthly \$120 billion in Treasury and mortgage bond purchases in the first quarter of next year, with further monthly cuts over the course of 2022—which ultimately, we think, will prove undisruptive for markets.

### Keep an eye on yield curves

We continue to monitor the shape of the Treasury yield curve, as we see it as one of the most reliable barometers of the U.S. growth outlook, a gauge of whether monetary policy is easy or tight, and a broad indicator of the overall stage of the business cycle.

While the yield curve garners the most attention when it inverts, or turns negative, ahead of rising recession risks, we think the re-steepening process at the early stages of an economic recovery can be just as important.

The slope of the curve between 10-year and 2-year Treasury yields recently peaked at around 1.5%. That's only about half the slope typically achieved in the immediate aftermath of a recession, when 2-year yields tend to drop along with Fed policy rate cuts while 10-year yields rise on recovering growth and inflation expectations.

Since the Fed's seemingly hawkish pivot at the June meeting, the 10-year/2-year curve has flattened significantly, to just 1.2%, on a combination of higher 2-year yields due to higher rate hike expectations, and lower 10-year yields as those same rate hike expectations may be seen as weighing on the economic outlook. While we think the recent flattening will likely prove temporary,

we would interpret further yield curve flattening as an indicator that markets believe the Fed to be at risk of removing monetary policy accommodation prematurely.

We continue to expect that the Fed will ultimately remain accommodative, and believe that yield curves are still in the process of steepening. Accordingly, we maintain our view that the benchmark 10-year Treasury yield is headed toward a range of 1.75% to 2.00% by the end of the year, and that 2-year Treasury yields will remain anchored around current levels, as we don't expect any Fed rate hikes until 2023.

### Central banks go their own ways

As the Fed charts its own path forward, so too do many other major central banks as the pace of vaccinations and economic recoveries remain on different trajectories.

Whereas the Fed appears to be nearing the point of withdrawing support, the European Central Bank (ECB) has left its accelerated pace of asset purchases unchanged, with few signs that it could be slowed meaningfully in the months ahead even as ECB policymakers have noted an improved economic outlook and a reduction in downside risks.

And that policy support is likely warranted, in our view. The key difference is that where the Fed sees inflation running just above its 2% target through 2023, the ECB still forecasts inflation to fall well short of its own 2% target through the same time horizon. That may keep a lid on the oft-watched German 10-year Bund yield, which recently came close to returning above 0% for the first time since 2019; RBC Capital Markets now believes it will not breach that level until the second quarter of next year.

The Bank of Canada (BoC) has been leading the pack in terms of dialing back policy support, cutting asset purchases in April and signaling a rate hike as early as next year. The

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## GLOBAL FIXED INCOME

Fed's hawkish pivot may help ease the cross-border burden of divergent policy stances, allowing the BoC to remain on track. Finally, we think the Bank of England is the least likely of the global central banks to make any major policy moves for the balance of the year, as uncertainty remains around the true state of the UK labor market's recovery.

### Portfolio positioning

The action for the rest of 2021 is likely to play out in global sovereign yields as markets reprice central bank expectations. Credit markets largely reflect a benign environment amid a robust economic outlook and vastly improved balance sheets, and valuations across the board remain on the rich side relative to historical averages.

In line with our expectation for sovereign yields to move higher, if only modestly, in most regions, we maintain neutral to relatively

short views in terms of yield curve positioning. With respect to credit markets, we remain comfortable adding some risk exposure in lower-rated credits to pick up incremental yield, with preferred shares in many regions still offering fairly attractive risk-adjusted yields, in our view.

### Stay the course

As central banks plot their various routes to the exits, we stress that policy support will likely remain accommodative to a historic degree for quite some time, and we think any reduction in support will be approached cautiously. There will undoubtedly be hiccups along the way as central bankers fine-tune their messages and plans—not to mention ongoing uncertainty around the path of the global pandemic—but for all of the talk around central bank policy changes, we think they will ultimately be broadly supportive of markets over any reasonably foreseeable horizon.

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### United States

■ At its June meeting, the Federal Reserve formally opened discussions around the process of tapering its ongoing \$120 billion per month in asset purchases, while now projecting two rate hikes by the end of 2023, up from zero at its March meeting. This hawkish pivot surprised markets and re-introduced broad-based volatility, and while it may persist, we think little has changed with respect to the Fed outlook—policy will remain accommodative for the economy and for markets for some time. While tapering plans will come into focus later this year, we don't expect the actual start until early next year, and that the window for rate hikes is unlikely to open before 2023.

■ Though the benchmark 10-year Treasury yield has fallen sharply over the past month as the potential for tighter Fed policy has weighed on longer-term growth and inflation expectations, we continue to expect yields to rise modestly through year end as the Fed's plans come into view, together with further progress on the fiscal spending front associated with the various infrastructure plans. The 10-year yield will likely head toward the 1.75%–2.00% range.

■ Credit market valuations continue to rise amid optimism around the economic outlook, the demand for

yield, and easy credit market access that has allowed companies to refinance debt and boost liquidity. Investors in investment-grade corporate bonds are now being paid just 0.82% in incremental yield over Treasuries for associated credit risks, near the lowest levels of the past 20 years. We continue to see value in the fixed-to-float preferred share market where investors can add yield, while adding protection via the fixed-to-floating rate coupon structure as the Fed edges toward a potential rate hike cycle over the next couple of years.

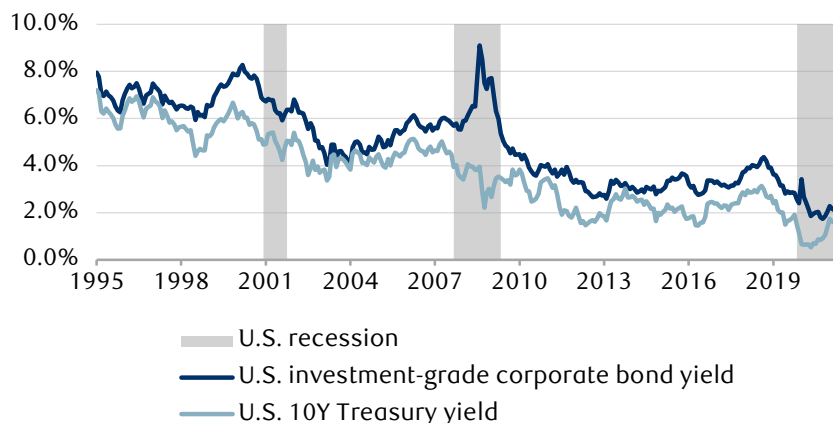
### Canada

■ While preferred shares and high-yield bonds have performed well this year, the yield premium offered for taking credit risk has remained in a tight range in recent months, particularly for higher-quality issuers. Those credit spreads have been kept unusually tight by very accommodative monetary policy and easy financial conditions; on the other hand, they have little room to narrow further given credit spreads are already hovering near historic lows. Outside of a significant reversal in the global fight against COVID-19, there is no obvious catalyst currently threatening this relatively benign credit environment.

■ For this reason, we think developments in underlying

### Investment-grade corporate bond, 10Y Treasury spread tighten

U.S. investment-grade corporate bond & 10Y Treasury yields



Source - RBC Wealth Management, Bloomberg

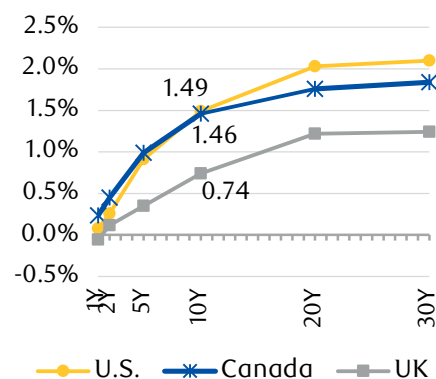
## REGIONAL FIXED INCOME

### 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	–	=	3–5 yr

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

### Sovereign yield curves



Source - Bloomberg; data through 5/24/21

government rates are likely to remain the key focus for fixed income investors in the second half of the year, which puts particular importance on communication from Bank of Canada (BoC) Governor Tiff Macklem going forward. The BoC's statements have positioned it as marginally more aggressive than most central banks; the Bank sees its first rate hike occurring at some point in H2 2022, compared to 2023 for the Federal Reserve.

■ Expectations for higher rates need not push investors to remain in short-term bonds only. In fact, we believe markets have already priced rate hikes into intermediate-term bonds that are more aggressive than BoC projections, anticipating two full hikes over the course of H2 2021 and H1 2022. These higher rate hike expectations provide some buffer to extend term, even in a rising rate environment.

■ With relatively little compensation for credit risk, and price upside constrained in high-yield and preferred shares, we believe modestly extending term in government or high-quality corporate bonds within a neutral fixed income allocation is appropriate until pockets of value begin to reappear.

### Europe & UK

■ The European Central Bank (ECB) announced it would maintain the Pandemic Emergency Purchase Programme (PEPP) at an elevated pace for the next quarter to keep financing conditions favourable. We expect the ECB to keep rates on hold this year, and markets are expecting rates to rise in late 2023—lagging other central banks in raising interest rates as the vaccination rollout and re-opening in the region have lagged and been more challenging.

■ The ECB is also undergoing a strategic review of its policy tools—a key focus will be managing price stability, which will set the tone

for inflation targeting. We expect the findings to be announced in September.

■ We suggest a Market Weight on eurozone sovereigns and corporate bonds. The bonds to fund the EU's €750 billion rescue fund are attractive to investors as the ECB asset purchases will be supportive, which could lead to outperformance in H2 2021, in our view. Corporate spreads should continue to be range-bound for the rest of 2021; therefore, the focus is on receiving coupon income. We prefer corporate credit issuers that are eligible for purchase under the Corporate Sector Purchase Programme, which will act to restrain any widening of those spreads.

■ In the UK, the Bank of England's Monetary Policy Committee (MPC) will likely be on hold for the rest 2021, in our view, and keep the current pace of purchases until the end of the year, as its forward guidance states "significant further progress" needs to be evident before the MPC will consider raising interest rates. Due to data lags, the true extent of the labour market challenges will probably be revealed in Q1 2022 once government support ends in September 2021.

■ We would hold an Underweight position on Gilts as we expect those yields to trend higher while the economy continues to reopen. Similar to European Credit, we also expect spreads, already at historic lows, to remain range-bound. We maintain a Market Weight on corporate credit, favouring non-domestic issuers and select domestic issuers.

### Asia-Pacific

■ The June pullback in U.S. treasury yields set the stage for Asia investment-grade to perform. The Biden administration taking a few high profile state-owned enterprises off its sanctions list, including ChemChina, China Three Gorges Corp,

## REGIONAL FIXED INCOME

and China State Construction Group, further underpinned the asset class.

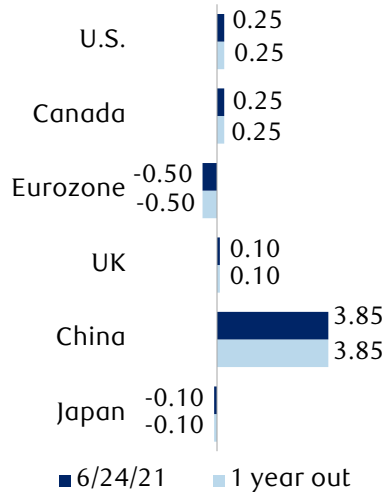
■ Meanwhile, headline concerns related to Huarong’s unsustainable debt loads also took a positive turn as the company announced it has started to dispose of seven units: five on finance, one on non-performing asset trading, and a local asset-management company. After disposing of about 700 billion yuan of combined assets, Huarong’s total assets should fall to about 1 trillion yuan, markedly alleviating its debt burden.

■ Asia high-yield continues to ride through a period of volatility as the Chinese government tightens policy on the China property sector. On top of the “three red lines” policy that was rolled out in mid-2020,

regulators announced two additional “red lines” restricting bank lending to the property sector, and started a centralized land auction policy on the land supply side. While bonds issued by the China property developers have underperformed, property sales have remained largely resilient so far.

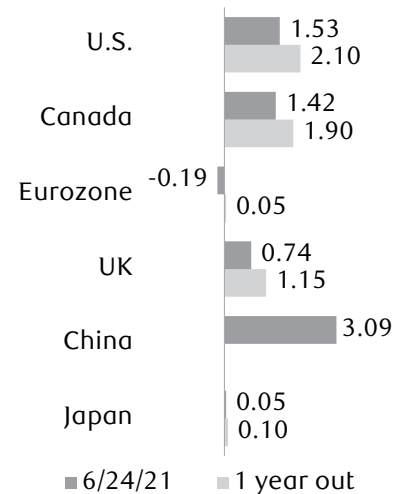
■ We expect the investment-grade segment to be mostly range-bound as credit spreads remain relatively low at some 130 basis points. Key drivers will be the direction in which U.S. yields move as well as any headlines regarding U.S. sanctions. As for high-yield, owing to the stricter policies directed at the China property sector, survival of the fittest will continue to be the rule, and property developers with decent scale and pricing power should stand out within the pack.

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

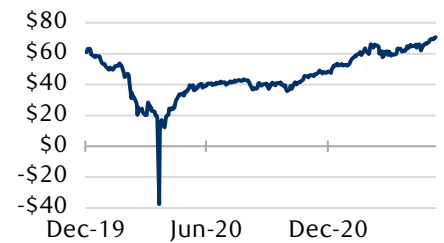
# Commodities

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## Crude oil: Early innings

RBC Capital Markets energy strategist believes we're in the early innings of a strong cycle and that West Texas Intermediate will likely exceed \$70/bbl in the back half of the year. The strategist argues that pared-back global inventories, the further tapering of OPEC spare capacity, and reopening demand are leading to a structurally tight supply environment and higher prices.



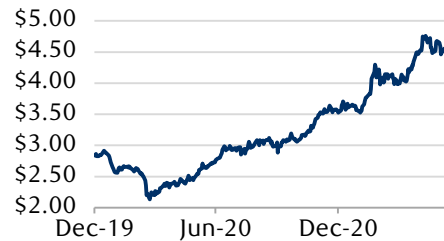
## Natural gas: Strong consumption

Natural gas prices have rallied roughly 30% YTD, driven in part by strength in liquefied natural gas exports and rising U.S. domestic consumption. The higher-than-anticipated demand is forecast to cause U.S. inventories to end the year 4% lower than the five-year average as tracked by the U.S. Energy Information Administration.



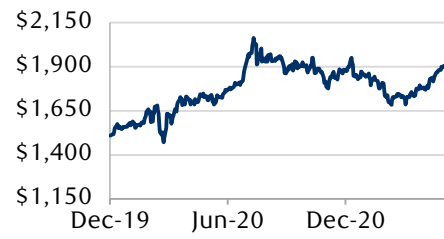
## Copper: Tight inventories

Copper is a beneficiary of reopening, but should also be supported by longer-term themes such as the transition towards green energy. While Chinese industrial activity has softened amidst a tightening in government policy, RBC Capital Markets sees copper inventories remaining tight for the rest of the year. Copper prices were up 39% in the year to May, but have since given back almost half of those gains.



## Gold: Aided by inflation

While gold has lagged in the face of a risk-on environment, the commodity managed to bounce off its 2021 lows and is effectively flat year to date. Stronger inflation should be a tailwind for gold, but low real rates remain the key driving factor, in our view. Real rates may drift higher towards year's end, but the increase should remain largely contained given high government debt levels.



## Commodity forecasts

Commodity	2021E	2022E
Oil (WTI \$/bbl)	\$67.64	\$72.27
Natural gas (\$/mmBtu)	\$3.10	\$2.95
Gold (\$/oz)	\$1731	\$1696
Copper (\$/lb)	\$4.00	\$3.75
Soybean (\$/bu)	\$6.54	\$6.00
Wheat (\$/bu)	\$14.28	\$12.38

Source - RBC Capital Markets forecasts (oil, natural gas, gold, and copper), Bloomberg consensus forecasts (soybean and wheat); data as of 6/14/21

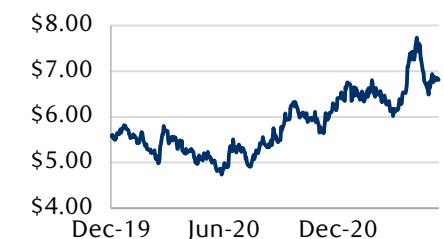
## Soybeans: Rising inventories

Soybean prices have retreated from 18-month highs but remain solidly in the green, up roughly 74% y/y. Looking ahead to the 2021/22 season, rising global production should result in modest inventory increases following a year of strong exports to China and drought conditions in the Americas.



## Wheat: Supply surplus

The USDA expects global consumption to reach record levels for the 2021/22 season, driven by higher feed and residual use in the EU. However, crop yields and production levels in Russia and North America are being scaled lower due to extreme weather. China is expected to account for approximately 48% of ending stock.



# Currencies

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### Currency forecasts

Currency pair	Current rate	Forecast June 2022	Change
<b>Major currencies</b>			
USD Index	91.81	96.80	5%
CAD/USD	0.81	0.79	-2%
USD/CAD	1.23	1.27	3%
EUR/USD	1.19	1.12	-6%
GBP/USD	1.40	1.19	-14%
USD/CHF	0.91	0.98	8%
USD/JPY	110.8	104.0	-6%
AUD/USD	0.75	0.73	-3%
NZD/USD	0.70	0.68	-3%
EUR/JPY	132.2	116.0	-12%
EUR/GBP	0.85	0.94	11%
EUR/CHF	1.09	1.10	1%
<b>Emerging currencies</b>			
USD/CNY	6.47	6.30	-3%
USD/INR	74.16	72.00	-3%
USD/SGD	1.34	1.31	-2%

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: Focus on tapering

The Fed was dovish throughout H1, but there was a change in tone at the June FOMC meeting with the median interest rate forecast indicating two hikes in 2023. Focus turns to August's Jackson Hole Economic Policy Symposium, where there is very likely to be a formal conversation on tapering. We look for the comparatively higher U.S. yields to keep the USD supported through H2, unless economic data in the U.S. unexpectedly weakens.

## Euro: ECB not ready to remove PEPP

The June ECB meeting underscored the importance of keeping the pace of the pandemic emergency purchase programme (PEPP), which contrasts with the Fed's move toward tapering, expected early next year. This perceived monetary policy divergence, coupled with consensus growth forecasts that favor the U.S., should potentially see the EUR underperform the USD in H2 2021. One risk to this view would be posed by a significant shift to European from U.S. equities.

## Canadian dollar: All the hawkishness priced in?

A hawkish taper by the BoC in April and soaring commodity and crude oil prices have made the loonie the top

performer in the G-10 so far in 2021. RBC Capital Markets' economists look for the Fed's tapering intentions to catch up to those of the BoC, resulting in a firmer USD/CAD in H2 2021.

## British pound: Limited scope for further gains

The pound had strong H1 2021 performance following hawkish comments by BoE members and an impressive vaccine rollout in the UK. A lot of good news has been priced into the GBP, and we expect further gains to be limited. Increasing tensions between the UK and EU regarding Northern Ireland will be something to watch over the coming months.

## Japanese yen: Driven by yield differentials

We expect yield differentials to remain the key driver for the JPY in H2, which puts the focus again on what the Fed does on the taper front. Analysts are keeping an eye on capital flows into Japan, which RBC Capital Markets' economists note have been neutral to positive for Japan and should give some support to the JPY.

## Dovish Fed comments in Q2 reversed the gains made in Q1 on the USD

U.S. Dollar Index



A hawkish tilt in the June FOMC statement puts focus on tapering at Jackson Hole.

Source - RBC Wealth Management, Bloomberg, data through 6/17/21



## Research resources

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			Count	Percent
Buy [Outperform]	762	55.46	299	39.24
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Sell [Underperform]	53	3.86	4	7.55

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