January 2020

RBC WEALTH MANAGEMENT

# Global Insight

Perspectives from the Global Portfolio Advisory Committee

## Buying power

### Will the U.S. consumer continue to drive growth?

With wages rising and a tight job market, we look for a healthy U.S. consumer to underpin continued economic growth in 2020.

Porcelli & Allworth | Page 4

Global equity
Overbought but not overdone


Global fixed income
Will central banks see the fruits of their labor?


Currencies
Canadian dollar: Fading support

Commodities
Natural gas: Inventory builds

**For important and required non-U.S. analyst disclosures, see page 20.**
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Wealth Management

# Table of contents



### Inside the markets

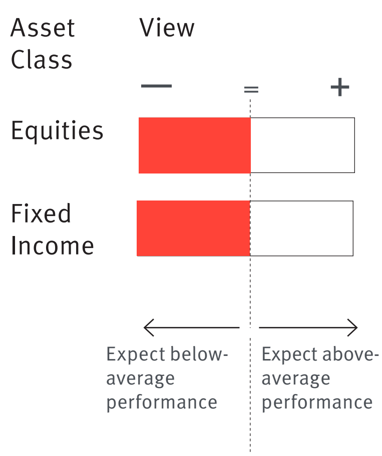


All values in U.S. dollars and priced as of market close, December 31, 2019, unless otherwise stated.

Global asset class view

# RBC's investment stance

Global asset views




See "Views explanation" below for details

Source - RBC Wealth Management

## Equities

- We have a constructive bias for equities with new highs forecast for 2020. Ultra-accommodative monetary policies already on the books, some additional fiscal stimulus, and a confident U.S. consumer should keep most developed economies growing moderately. That should engender growth in corporate earnings, dividends, and buybacks.
- Right alongside this is a heightened need for caution acknowledging that the late stage of the business cycle carries particular challenges for the economy and stock market. In our view, GDP growth for the major economies is unlikely to kick into a higher gear that would usher in several successive years of above-average earnings growth. But as long as U.S. recession risks remain in the distance, as shown by our indicators, we believe portfolios should maintain a Market Weight allocation to equities.

## Fixed income

- The benchmark 10-year U.S. Treasury yield has held the 1.5%–2.0% range for nearly four months, recently returning toward the top end of that range. The German benchmark 10-year Bund yield remains negative, but has reached -0.2%, the highest level since May 2019. Global growth and inflation expectations have recovered on the back of recent central bank easing, but with the major global central banks now likely to be on hold for the time being, we continue to see the ceiling for developed sovereign yields to be near current levels as broad uncertainty is likely to remain. RBC Capital Markets forecasts the U.S. 10-year to peak at 2.1% in 2020, while expecting the German 10-year yield will gradually recover back to 0.0% by the end of 2020.
- We maintain our Market Weight in global fixed income. Though global yields remain historically low, so too do their ceilings. As we expect market volatility to be higher in 2020 than it has been recently, we look to fixed income to provide some defense and stability for portfolios.

## Views explanation

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

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

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

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

Focus article

# Buying power

## Will the U.S. consumer continue to drive growth?

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The consumer is the main engine of the U.S. economy, and with rising wages and a strong employment picture, the consumer appears to be in great shape as the new year begins. Jim Allworth discusses the importance of consumer spending with RBC Capital Markets' Chief U.S. Economist Tom Porcelli.

**JA –** Tom, you've been adamant for a long time that the pulse of the U.S. consumer is strong and, as long as it remains so, a recession is unlikely to arrive. One would never come to that conclusion reading the daily headlines.

**TP –** That's for sure. If I was to make a blanket statement it seemed, at least for a time there, no matter how good (or even OK) a data point was, it was interpreted as negative. It was rarely "This is the sign of a strong economy that has staying power."

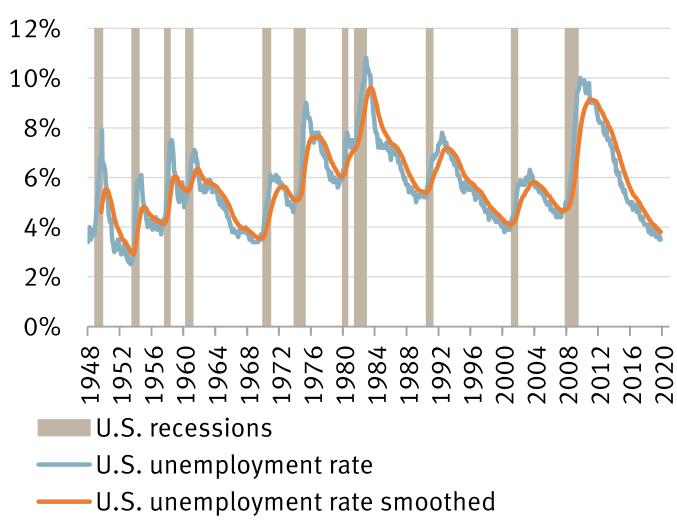
I travelled a lot more than usual in 2019, visiting clients here at home and abroad. Almost every meeting was an uphill struggle when it came to persuading our clients the expansion had further to run because the consumer—the dominant engine of the U.S. economy—was in great shape and showing no signs of running out of steam.

**JA –** What is the basis for your conviction about the staying power of the U.S. consumer?

**TP –** Well, the employment picture is definitely the biggest brick in the wall. Tight labor markets suggest wage pressures will continue. The unemployment rate sits

It's been a long time since unemployment was this low

U.S. unemployment rate (U-3 rate %)




Source - RBC Wealth Management, Federal Reserve Bank of St. Louis (FRED); data through 10/31/19

The U.S. labor market is at its tightest in 50 years …

Tom Porcelli is Managing Director and Chief U.S. Economist at RBC Capital Markets, LLC. He focuses on piecing together the U.S. economic backdrop as part of the global economic effort. Tom travels globally to meet with RBC clients to share his insights on the U.S. economy and markets. He appears regularly on CNBC and Bloomberg and is quoted widely in the global press.

near a 50-year low and is below most estimates of "full employment." Unemployment claims near all-time lows suggest not a whiff of stress in the labor backdrop. And just to drive the point home, at present there are 7.3 million jobs available versus 5.8 million unemployed. Think about that. There are significantly more job openings than the number of unemployed. This is something that has never happened in the history of the data. Furthermore, the National Federation of Independent Business, which surveys its more than 300,000 small and medium sized business members monthly, reports that 26% (1% below the record high) cite the inability to hire qualified workers as their single biggest problem; in the most recent survey (November 2019), 61% of firms reported attempting to hire someone, and 88% of them were unable to find a qualified applicant. In other words, it is not at all heroic to say wage pressures will continue, and thus spending should continue to chug along.

A high percentage of firms surveyed are raising wages or are planning to. One of our highest-conviction calls for 2020 is for a further acceleration in wage growth. Average hourly earnings growth moved convincingly above the 3% mark (y/y) for the first time in a decade a little more than a year ago. We think that pace will be maintained or surpassed in 2020.

### Wages are on the rise

Real median weekly wages (1982–84 CPI adjusted dollars)


Source - U.S. Bureau of Labor Statistics; quarterly data through September 2019

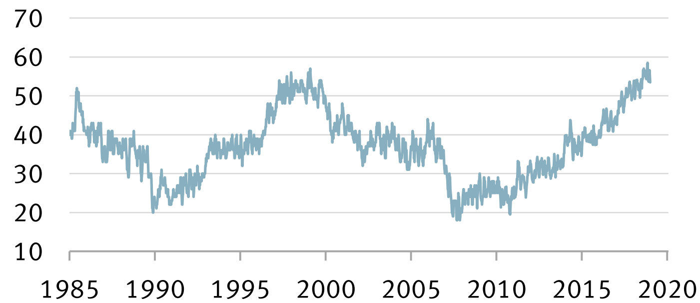
**JA –** Can the employment picture improve further from this point on?

**TP –** Yes it can. The average monthly employment gain was 186,000 positions over the past year, but we think that will slow down this year, to something closer to 125,000 per month. Meanwhile, the number of people entering the labor force each month also looks set to slow from about 140,000 down to 100,000. As long as the number of new jobs exceeds the number of new entrants to the labor force (the "break-even" level) then the unemployment rate will continue to decline. On balance, that's what we think will happen over the course of the coming year.

But job creation and the unemployment rate only tell part of the story. The best way to gauge the consumer's ability to drive spending is through wages. Production (non-supervisory) workers comprise more than 80% of the U.S. workforce, and their real aggregate wages—that is, wages after taking out the effect of inflation—are growing at close to a 3% y/y pace, well above the long-term average. Given the tightness of the

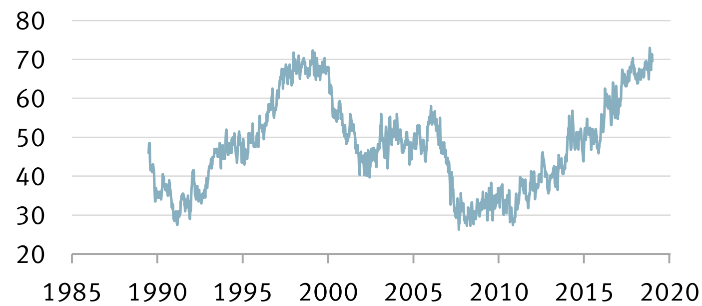
### The U.S. consumer is smiling

Bloomberg US Weekly Buying Climate Positive Net Index




... boosting the confidence of the U.S. consumer.

Bloomberg US Weekly Consumer Comfort Index for full-time employed




Source - Bloomberg, RBC Capital Markets U.S. Economics; data through 12/15/19

labor market, there is almost no reasonable argument to be made that casts doubt on the consumer's ability to drive spending in the coming year at a better than 2% pace.

It's no wonder consumer confidence readings are elevated.

**JA –** Are there any signs that buoyant consumer confidence is inducing reckless spending?

**TP –** Far from it. In the eleventh year of this longest-ever economic expansion, the consumer's reaction to extreme labor market tightness and the job security it implies, as well as to rising wages, has been to save more. Needless to say, this is an atypical reaction. In fact, our saving model suggests that given this feel-good backdrop the consumer should be drawing down savings. Instead, the saving rate remains elevated in the U.S. at about 8%. And households continue to de-lever despite extraordinarily low interest rates. Credit card delinquencies are running at a rate only slightly above the all-time low reading posted back in 2015.

As we think about 2020, there is almost no getting around the fact that the consumer will again be the engine. On the face of it, calmer waters on the trade front would suggest businesses' capital expenditures (capex) could show some lift in the coming year, but we would caution against placing too much optimism here. Even if trade worries completely vanish, we still have the coming presidential elections that could add a dose of uncertainty to the backdrop. Thus we do not see capex helping propel growth in any material way. Rather, the consumer will again shoulder the burden. Luckily, they can.

**JA –** Thanks Tom, and all the best for 2020.

Global equity

# Overbought but not overdone

A glance at the headlines would tell anyone that 2019 was a good year for all the major equity markets. The parade was led by the U.S., where the S&P 500 returned 29% not including dividends.

This sparkling performance was dimmed a bit by the fact some of the advance was just making up the ground lost in the August to December stock market swoon of 2018. It's also fair to say that right up to the middle of October no one was characterising 2019 as "a great year for equities." Those superlatives arrived only after the rocket ride which saw the S&P 500 soar by 13% in just 12 weeks. That's an annualised run-rate of 70%. Every developed economy stock market enjoyed a strong lift over the same few weeks.

It's perhaps stating the obvious to say stock markets became somewhat overbought in the process; but not fatally, in our view. Take investor sentiment* for example: the August–October stretch featured extraordinarily pessimistic readings in the U.S., when "bears" often outnumbered "bulls" by more than two-to-one. That kind of upside-down reading is usually only seen at the bottom of a drawn-out, punishing market decline. We would characterise today's more optimistic readings as "firmly bullish" but not wildly so. There's a well-below-average number of bears lurking out there, but the most recent number of bulls is about average. In other words, sentiment measures today are not at one of those unsustainable extremes that let you predict with confidence where the market trend might be headed next.

### Equity views

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

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

Nor are equity valuations as worrisome as they might first appear. Yes, the price-to-earnings (P/E) multiple of the S&P 500 went from a depressed 15.6x forward earnings at the beginning of 2019 up to a richer 18.6x by the end of the year. But over the same interval, the Moody's Seasoned Baa Corporate Bond Yield (in our view, a good proxy for the yield on the average S&P 500 company's debt) fell from 5.10% to 3.90%. Or to put those yields on the same arithmetic footing, they climbed from 19.6x their coupon to 25.6x.

To be consistent, a more testing time for equity valuations will likely come when corporate bond yields are next moving higher. We are of the view that is largely in the hands of central banks, all of whom appear committed to maintain their lower rate bias through 2020. We are not of the view that a "strong 2019" performance dooms the market to a below-average plod or worse in 2020. Not counting the multiyear, tech-driven melt-up of the late 1990s, since 1950 there have been 11 instances of the S&P 500 delivering back-to-back yearly gains of greater than 10%.

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*American Association of Individual Investors Sentiment Survey, January 2, 2020

Which brings us back to our oft-stated strategic stance—the best way to see a bear market heading for global equity markets is to correctly anticipate the arrival of an economic downturn (in particular a U.S. recession) ahead of time. To quote from the "Eyes wide open" focus article in our recently published *Global Insight 2020 Outlook*, "Accommodative monetary policy, some additional fiscal stimulus, and a confident consumer should keep the U.S. and most other developed economies growing through next year and probably longer. That should engender growth in corporate earnings, dividends, and stock buybacks. Share prices should follow all these higher."

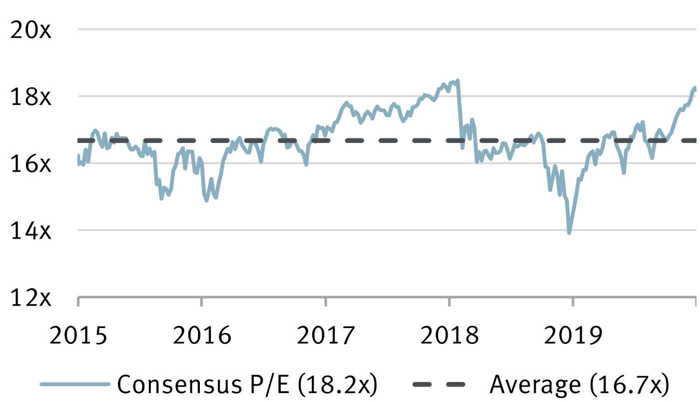
We continue to recommend portfolios carry equities at a predetermined, long-term target weight. However, that constructive, optimistic outlook should necessarily be accompanied by an elevated commitment to vigilance and a willingness to lean against risks when they appear.

## Regional highlights

### United States

- We think patience will be a virtue for investors in 2020, following a strong run in 2019. Our key indicators are signaling the domestic economic expansion will persist for at least another year and, therefore, we have a constructive outlook for the market. The strength of the U.S. consumer is the key to this story, in our view. Unemployment is at a 50-year low and wages are rising nicely. We believe this sets the table for higher consumer spending in 2020.
- Yet we anticipate S&P 500 earnings growth will be moderate, in the mid-single-digit range, and there may be some hiccups in the domestic economy as the 10-year-old cycle ages. Also, global growth could face headwinds due to lingering structural challenges in China and Europe, and trade and tariff tensions could resurface.
- A still-expanding domestic economy, combined with a modest advance in earnings and revenues, should be "good enough" to deliver somewhat higher U.S. equity prices in 2020. The S&P 500 is now trading at 18.6x RBC Capital Markets' 2020 earnings forecast of $174 per share versus a five-year average of 16.7x. While the valuation is elevated and has less room to expand, it is not unreasonable considering the ultralow interest rate environment. We think a Market Weight allocation to U.S. equities remains appropriate. We favor value stocks, including the Financials sector, over growth stocks.

S&P 500 next-twelve-month P/E ratio, five years




Slightly elevated valuations may act as a ceiling for 2020 returns, but we do not anticipate a repeat of the contraction in multiples that the market experienced in 2018.

Source - RBC Wealth Management, FactSet, Bloomberg; data through 12/31/19

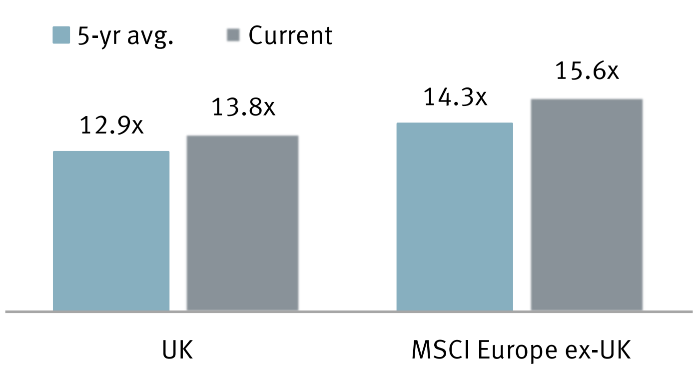
### Canada

- We recommend a Market Weight allocation to Canadian equities. Domestic-specific challenges, including elevated household leverage, strained affordability in key housing markets, and insufficient oil & gas pipeline capacity, remain in focus. We view these issues as well documented and reflected in the valuations of the most directly affected industries.
- Canadian banks are trading at a modest discount to their long-term average price-to-earnings valuation, which we believe is appropriate. We expect 2020 earnings growth at the low end of banks' medium-term targets as weaker economic growth and rising credit provisions serve as headwinds. We are mindful that credit losses could rise materially if the economic outlook darkens as new accounting measures dictate a more forward-looking approach.
- The outlook for the Energy sector continues to be clouded by a muted commodity backdrop and ongoing market access issues. While prospective new pipeline projects remain beset by delays, Canadian energy producers face a diminished investment appetite and the risk of wider price discounts. Tangible progress in advancing the Line 3 Replacement or Trans Mountain Expansion could help sentiment despite post-2020 in-service dates.

### Continental Europe & UK

- We recently upgraded Europe to Market Weight. The U.S.-China trade tensions-induced slowdown is showing signs of abating, and the economy could be close to bottoming. Political headwinds, such as a populist government in Italy and a hard Brexit, have not materialized. A stabilization in global economic momentum would benefit the region, and we note rumblings regarding fiscal stimulus have become more persistent. Valuations are not demanding. We would seek opportunities in well-managed companies with strong business models and balance sheets, and whose prospects are buoyed by secular growth drivers.
- Meanwhile, in the UK, the Conservatives gained a large majority in the elections thanks to a pledge to increase government spending and to "get Brexit done." As such, the UK will leave the EU at the end of this month with a one-year transition period during which the status quo will prevail. Prime Minister Boris Johnson has ruled out an extension to this transition period so that should a free trade agreement not be in place by December of this year, the UK may well have to fall back on

European valuations, next-twelve-month P/E ratios




The UK looks attractive relative to Europe and the broader global opportunity set on a valuation basis and supports our recently upgraded Market Weight recommendation for the UK.

Source - RBC Wealth Management, FactSet, Bloomberg; data through 12/31/19 unfavorable World Trade Organization terms.

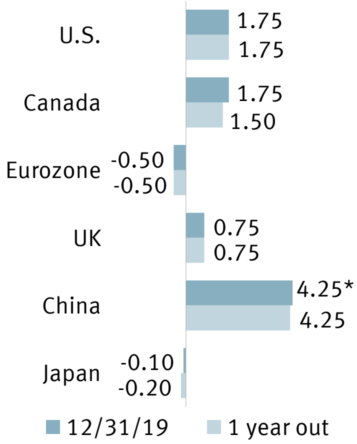
- A more generous fiscal stance can underpin growth, but the risk is that the Brexit uncertainty regarding the future trading relationship with the UK's largest trading partner may well continue to be a headwind.
- For now, weighing attractive valuations versus this uncertainty, we choose to be Market Weight UK equities with a balanced approach to domestic and internationally focused stocks.

### Asia

- We expect modest economic growth in Japan in 2020 following the hike in the consumption tax in October 2019. Monetary policy will likely remain accommodative. Growth will also be supported by the newly announced, larger-than-expected, 26 trillion yen fiscal package. Meanwhile, there are initial signs of cyclical indicators bottoming. Despite decent consensus earnings growth expectations for 2020, we believe Japan is one of the most undervalued developed markets. We remain constructive on the long-term outlook of Japanese equities.
- 2020 may prove to be another eventful year for Chinese stocks, as market participants will look for clues on whether the country can contain economic downside risks. Beijing may continue to support the economy through: (1) reserve-requirement ratio reductions, (2) tax cuts, (3) trimming borrowing rates, (4) reverse repurchase agreements, (5) propping up sectors most at risk, and (6) focusing on infrastructure projects. Policymakers will likely try to control risks by preventing the base rate for new corporate loans from falling meaningfully, as an over-extension of credit could expose the financial sector to systemic risks, in our view. As for the trade impasse, despite a phase one trade deal being reached, a full pact may not be reached until the U.S. presidential election draws closer.
- The Hang Seng Index's trajectory will largely depend on: (1) trade progress and (2) whether the unrest in Hong Kong ends soon. The city is now in a technical recession, and upcoming economic data may point to a continued deceleration. Despite the gloom, any alleviation of political tensions may bring about opportunities, particularly as the Hang Seng carries a 12-month forward price-to-book ratio of 1.23x and an undemanding forward price-to-earnings ratio of 11.1x.

# Will central banks see the fruits of their labor?

Central bank rate (%)




*1-yr base lending rate for working capital, PBoC

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

In the face of slowing global growth and rising uncertainty, the central banks of the U.S., Europe, and China moved to ease policy in 2019, while the central banks of Canada and the UK managed to keep policy rates steady. But after planting the seeds of stimulus in 2019, will central banks harvest higher growth and inflation in 2020? The early indications suggest reasons for optimism, in our view.

In Europe, the ZEW Eurozone Expectation of Economic Growth Index—a survey of 350 experts—has recovered sharply from the near-decade lows of last summer to reach the highest level since early 2018 as of December.

In the U.S., economic surprise indexes have turned positive, and the labor market continues to fire on all cylinders as the unemployment rate has declined to a 50-year low of just 3.5%. The yield curve inversions that sparked recession fears six months ago have all but disappeared, a reflection of both the Fed's interest rate cuts and higher—if not still subdued—growth and inflation expectations among market participants.

But what might better growth and inflation mean for the broader yield landscape? For all intents and purposes, global central banks are likely to keep policy rates on hold in 2020, acting as an anchor for rates at the front end of sovereign yield curves. The question then is, how far can yield curves re-steepen should 10-year yields reflect greater optimism?

Put simply, we think the bulk of the re-steepening of yield curves and renewed optimism has already occurred and that yield curves should remain relatively flat until central banks determine their next moves. For the U.S. that means a 10-year yielding around 2% in 2020. In Europe, the German 10-year could return to positive territory, if only slightly above 0%. The UK perhaps faces the most upside risk from current levels, as the 10-year has scope to move north of 1% should the path to Brexit clear and as fiscal stimulus props up the economy. All of those levels are within 0.20% of 2019 closing levels.

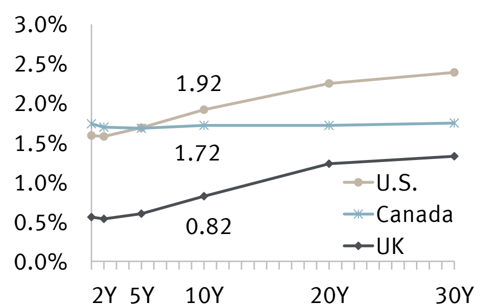
All told, we believe the stunning global decline in yields that marked 2019 is

## Fixed income views

| Region | Gov't Bonds | Corp. Credit | Duration |
|---|---|---|---|
| Global | = | + | 5–7 yr |
| United States | = | + | 7–10 yr |
| Canada | = | = | 3–5 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 12/31/19

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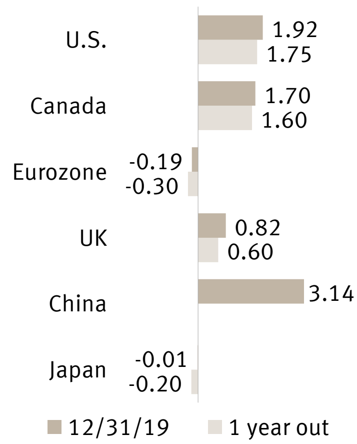
# Global fixed income

10-year rate (%)




Note: Eurozone utilizes German Bunds.

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

unlikely to be repeated in 2020, but it's equally as unlikely to be completely reversed. While broad uncertainty is likely to remain, one source of certainty may come from central banks staying put, and that could mean that yields simply end 2020 right where they began.

## Regional highlights

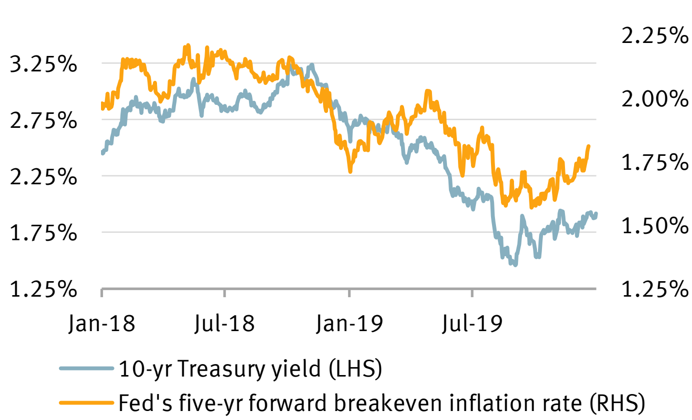
### United States

- The Fed should feature less prominently in markets for at least the first six months of the year as officials clearly believe monetary policy is in the "right place" to support the economy into 2020. With the Fed on the sidelines as it assesses the impact of recent rate cuts, and as global uncertainties fade somewhat, attention will turn back to the U.S. economy's fundamentals in determining the Fed's next steps. Inflation expectations have increased since the Fed started cutting rates last summer, helping the 10-year Treasury yield to rise toward 2%. However, we continue to believe that actual inflation will remain below the Fed's target, keeping the ceiling for Treasury yields near current levels.
- Investment-grade corporate bonds returned 14.8% in 2019, capping the best year of the decade, but don't expect a repeat performance in 2020. The Bloomberg Barclays US Corporate Bond Index now yields just 2.84%, and just 0.93% over Treasuries. With both having limited scope to move lower in 2020, in our view, investors should expect coupon-like returns. However, investment-grade corporates should provide traditional ballast and stability for portfolios should broader market volatility rise in the months ahead.
- It remains the case that municipal bond investors may find relative value in extending on muni curves. As yield curves, generally speaking, have steepened in recent months, muni investors are now being paid about 1.1% in incremental yield to move from the short end to the long end of muni curves. That yield pickup was recently as low as just 0.8%.

### Canada

- The Bank of Canada (BoC) bucked the easing trend by keeping its monetary policy unchanged through 2019 as the domestic economy was buoyed by a firm employment backdrop while actions by other central banks provided a helping hand. For example, Government of Canada bond yields tracked their U.S. Treasury market equivalents lower in 2019, providing Canadian households with a well-

Rising inflation expectations helping 10-year yield toward 2.00%




We continue to believe actual inflation will remain low, keeping the 10-year yield near current levels.

Source - RBC Wealth Management, Bloomberg; data through 12/31/19 needed respite through lower mortgage rates. Questions remain over the solidity of economic growth through 2020 with an uncertain contribution from household spending and a delayed weakness in the manufacturing sector pitted against higher federal government spending and a housing market resurgence.

- The flatness of the yield curve suggests the bond market believes the BoC will remain on hold for as far as the eye can see. We view short- and intermediate-term bonds as an attractively priced way to lock in reasonable yields for the next few years in case the BoC eases policy. Canadian Real Return Bonds offer what we think is an attractive way to source longer-term exposure given market-based expectations for inflation in Canada are near all-time lows. A more accommodative policy stance could revive these muted inflation expectations.
- Corporate bonds currently offer modest yield enhancement versus government bonds. Accordingly, we continue to favour upgrading credit quality and liquidity within bond portfolios. Preferred shares are the one exception to this given they are the most attractively valued category in Canadian credit. Widespread investor pessimism has created an opportunity to lock in materially higher yields than what is available on longer-term corporate bonds from the same issuers. In our view, concerns about the impact of lower yields on the cash flow profile of rate-reset preferred shares are already embedded in current pricing.

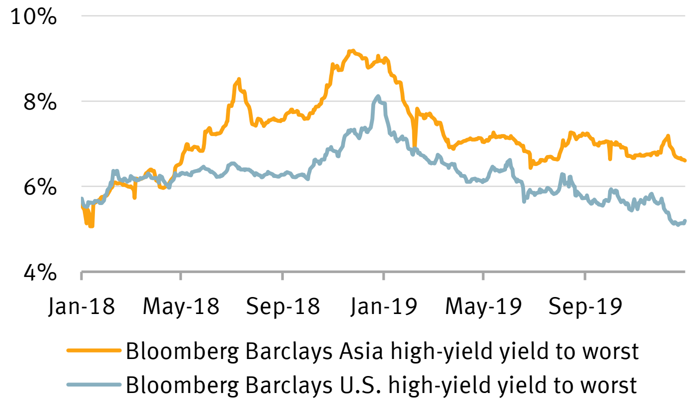
### Continental Europe & UK

- European Central Bank (ECB) monetary policy continues to be on pause following September's substantial stimulus package and Christine Lagarde becoming ECB president in November. Continuing soft economic data may warrant an additional interest rate cut or extension of quantitative easing.
- There is an expectation among some market participants that individual euro area countries may provide a fiscal boost to their domestic economies. This depends on the appetite of each government for stimulus and the budgetary restrictions of the EU Commission. We remain comfortable with our Market Weight stance on government bonds and our Overweight view on corporate credit for Europe.
- Following last month's UK general election, we have reduced our view on UK government bonds to Underweight from Market Weight, and continue to target the 3- to 5-year duration bucket. With a significant majority now in place, the Conservative government is in a position to implement its manifesto, including the imminent UK withdrawal from EU membership, along with budgetary spending plans as set out late in 2019.
- With the uncertainty regarding the UK's exit removed, and the potential for a pickup in economic momentum, we see UK government bond 10-year yields likely to rise to a level well above 1% during 2020. We also expect the Bank of England will resume its hawkish bias for tighter monetary policy, with the potential for interest rates to be raised during the second half of 2020, if not sooner if the economic data is supportive.
- We continue to maintain our Market Weight view on UK corporate credit for the attractive pickup relative to government bonds.

### Asia

- China's economy is expected to continue slowing in 2020, with GDP growth likely to fall below 6%, based on

Asian high-yield bonds offer yields of 6.6%, 1.4% more than U.S. high yield




Asian high-yield bond valuations remain attractive in both absolute and relative terms.

Source - RBC Wealth Management, Bloomberg; data through 12/31/19

the Bloomberg consensus forecast. We anticipate the policymakers' response will continue to be walking the thin line between keeping the country's debt under control and using targeted fiscal and monetary measures to cushion downside risks.

- This scenario extends the valuation case for Asia high yield in 2020, in our view, and we remain Overweight the sector. Although fundamentals will be of concern and require close monitoring, we think the valuation is attractive in both absolute and relative terms. Asia high yield currently offers a 6.6% yield and a yield pickup over U.S. high yield of 1.4% based on Bloomberg Barclays Asia and US Corporate High Yield Bond Indices. Investors should, however, be prepared for volatility spikes on headline news, which picked up in Q4 2019.
- We expect idiosyncratic risk to be high for Asia fixed income and would maintain a well-diversified portfolio. We believe credit differentiation among investors will pick up in 2020, and we see a diverging trend between good and bad names. Within China fixed income, we prefer the Properties sector over Industrials. Outside China, we are cautious on India due to its challenging growth and fiscal dynamics.
- As we move further into the late stage of the economic cycle, capital preservation is key, and we would stick to quality names. We see the sweet spot in the higher BB-rated credits within Asia high yield. We are Market Weight Asia investment grade.

# Currencies

## Currency forecasts

| Currency pair | Current rate | Forecast Dec 2020 | Change* |
|---|---|---|---|
| Major currencies | | | |
| USD Index | 96.38 | 96.83 | 0% |
| CAD/USD | 0.76 | 0.75 | -1% |
| USD/CAD | 1.29 | 1.33 | 3% |
| EUR/USD | 1.12 | 1.12 | 0% |
| GBP/USD | 1.32 | 1.35 | 2% |
| USD/CHF | 0.96 | 1.01 | 5% |
| USD/JPY | 108.61 | 109.0 | 0% |
| AUD/USD | 0.70 | 0.66 | -6% |
| NZD/USD | 0.67 | 0.62 | -7% |
| EUR/JPY | 121.77 | 122.0 | 0% |
| EUR/GBP | 0.84 | 0.83 | -1% |
| EUR/CHF | 1.08 | 1.13 | 5% |
| Emerging currencies** | | | |
| USD/CNY | 6.96 | 7.07 | 2% |
| USD/INR | 71.37 | 71.70 | 0% |
| USD/SGD | 1.34 | 1.35 | 1% |

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

### U.S. dollar: Carry on

The U.S. dollar continued to grind higher in 2019 despite a dovish Fed, thanks to safe-haven demand emanating from trade tensions and a resilient domestic economy against a backdrop of slowing global growth. Although U.S. economic growth could slow in 2020, so long as this does not derail the broad economic expansion narrative, the dollar should remain supported, in our view.

### GBP: Brexit, and then ...?

The pound is still much below its pre-referendum level and will remain hostage to political developments as the UK and EU try to negotiate a trade agreement before the 2020 year-end deadline. Although the Conservatives' decisive election victory offered some clarity, with challenges ahead, weak economic momentum, and a no-deal Brexit still possible, we maintain a neutral outlook.

### Canadian dollar: Fading support

With the Bank of Canada on the sidelines, the Canadian dollar traded in a relatively tight range in 2019. However, slowing global growth and trade concerns could tee up a rate cut in mid-2020, in our view. In the absence of support from positive rate dynamics, the Canadian dollar could trend moderately lower towards the end of the year.

### Euro: Growing pains

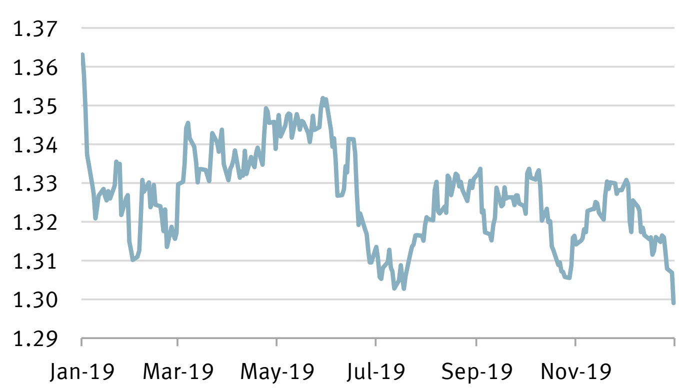
Euro weakness prevailed through 2019 as economic activity slowed and continued to disappoint. After delivering a comprehensive stimulus package, the European Central Bank could remain on hold through most of 2020, limiting downward pressure on the euro. But the challenging growth outlook points to little impetus for a material euro recovery for now, and we maintain a neutral outlook.

### Japanese yen: Looking abroad

Concerns about the slowing global economy prompted the Bank of Japan to deliver dovish forward guidance, and ultra-loose policy could persist through 2020. However, external factors could be key drivers for the yen. Notably, Japanese investors' appetite for unhedged higher-yielding assets abroad could cap gains from safe-haven demand.

The Canadian dollar staged a late-December advance, lifted by positive trade headlines

USD to CAD




The Canadian dollar was the best performing G-10 currency in 2019, but headwinds make a repeat performance in 2020 unlikely.

Source - RBC Wealth Management, Bloomberg; data through 12/31/19

**Blaine Karbonik, CFA**
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blaine.karbonik@rbc.com

# Commodities

## Commodity forecasts

| | 2020E | 2021E |
|---|---|---|
| Oil (WTI $/bbl) | $58.07 | $58.07 |
| Natural Gas ($/mmBtu) | $2.45 | $2.55 |
| Gold ($/oz) | $1,500 | $1,450 |
| Copper ($/lb) | $3.00 | $2.75 |
| Soybean ($/bu) | $9.05 | $9.10 |
| Wheat ($/bu) | $5.03 | $4.88 |

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

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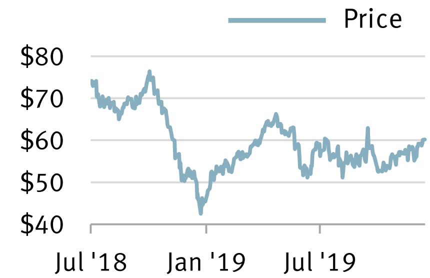
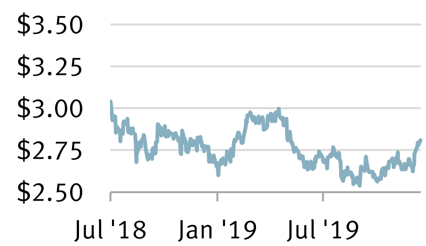
richard.tan@rbc.com

**WTI – Range-bound**
Despite turbulent intraday swings in 2019, RBC Capital Markets expects WTI crude oil to trade between $50 and $60 per barrel over the next 12–18 months, capped by excess global supply and slowing demand growth. OPEC reiterated its commitment to balancing the market by curtailing an additional 500,000 bbl/d last December. The International Maritime Organization’s 2020 regulations went into effect at the beginning of the year, and aim to reduce maritime sulphur emissions by over 80%.

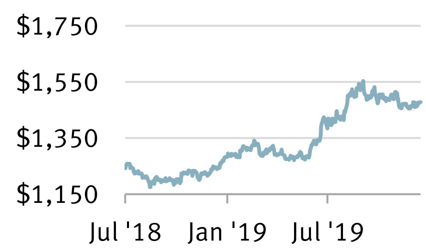



**Natural gas – Inventory builds**
Demand for cleaner energy continues to paint a favourable backdrop for natural gas over the longer term. However, we believe near-term upside remains limited due to larger-than-average inventory build-ups. RBC Capital Markets forecasts production to outpace demand through 2021. U.S.-China trade relations have improved at the margins but future demand growth may be more tepid if China slows further, in our view.

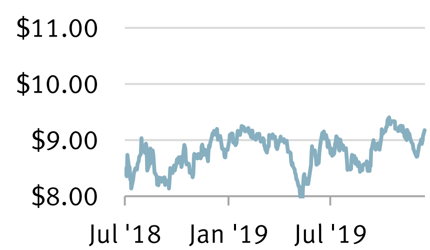

**Copper – Supply surplus**
U.S.-China trade uncertainty and a further deceleration in global manufacturing would impede any significant rally in copper, in our view. We also believe China’s monetary and fiscal packages are more likely to stabilize demand than to spark a new growth phase. Supply and demand fundamentals are pointing towards a surplus position until 2021. U.S. plans to cancel freshly imposed tariffs on certain consumer electronics may give copper a slight lift.



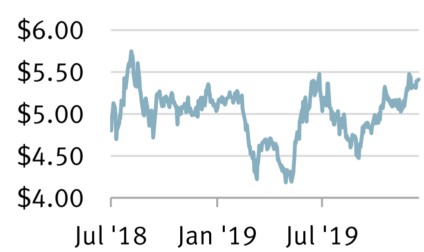

**Gold – Consolidation**
Gold rallied in 2019 as central banks eased monetary policies further. We expect less accommodation in 2020 as the market is pricing in less than one rate cut from the Fed. The outcomes of the U.S.-China trade dispute and Brexit, and the timing of these events, should be key drivers of gold in 2020. The impeachment process in the U.S. and investors’ risk appetites could also play a role.




**Soybeans – Phase one**
Soybean pricing has been volatile since the emergence of the U.S.-China trade dispute in mid-2018. The market is anticipating a phase one trade deal whereby China would ramp up purchases of U.S. agricultural goods to $40B-$50B per annum over the next two years. U.S. exports remain below pre-trade war levels but should increase going into 2020.

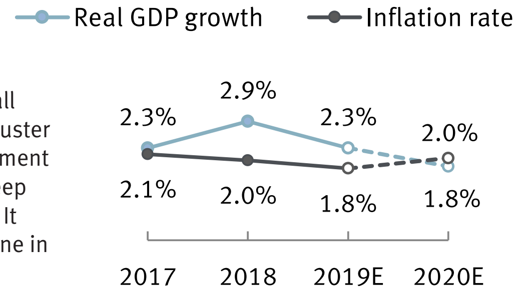



**Wheat – Record high**
The U.S. Department of Agriculture is lowering its 2019/2020 global production forecast, driven by unfavourable weather conditions and reduced consumption rates. The U.S.-China phase one trade agreement may increase demand for U.S. products, but Russia still commands the leaderboard for global exports. Global ending stocks hit a record high of 290 million tonnes in November 2019, with approximately half within China’s storage.

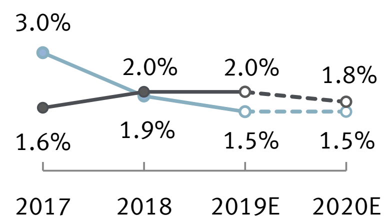



Source - RBC Wealth Management, Bloomberg; date range: 7/1/18–12/16/19

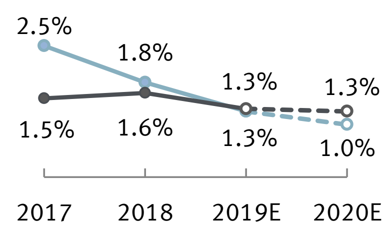
# Key forecasts



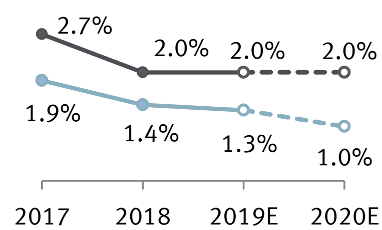

**United States – No more rate cuts**
U.S.-China trade progress boosted consumer and small business confidence, both already elevated. A blockbuster 266,000 jobs created in November pushed unemployment down to 3.5%. As we begin 2020, the Fed will likely keep interest rates unchanged after three rate cuts in 2019. It will buy $60B of Treasury bills per month at least to June in response to volatility in the repo market.



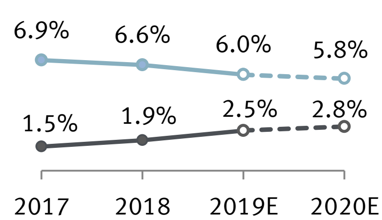

**Canada – Surprising job losses**
Unlike other major central banks, the Bank of Canada kept policy rates unchanged in 2019 as solid job growth and inflation near target provided cover for the pause. However, the unemployment rate rose 0.4 percentage points to 5.9% in December as over 70,000 jobs were lost, and markets now expect the BoC will cut rates to combat the weakness, with manufacturing data hovering near contraction territory and GDP forecasts muted.



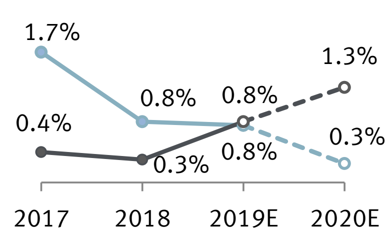

**Eurozone – Manufacturing weakness remains**
Despite continued weak manufacturing activity, eurozone Q3 GDP managed to grow 0.2% q/q. While regional purchasing manager indexes (PMIs) have found a footing, GDP growth is expected to slow to 1% y/y in 2020, from 2019's estimated 1.2% y/y. New European Central Bank President Christine Lagarde emphasized the importance of fiscal policy in assisting the ECB in achieving its inflation goal faster and with fewer side effects.




**United Kingdom – Brexit progress**
The Bank of England held its rate at 0.75% in its latest policy decision as Boris Johnson's election victory means government policy is likely to be in line with the assumptions made in the BoE's latest forecasts. UK manufacturing felt the global slowdown as industrial production fell 1.3% y/y in October and manufacturing production declined 1.2% y/y. PMIs don't suggest any reacceleration in the near future.




**China – Trade truce**
The U.S. and China announced a phase 1 trade deal has been agreed. Tariff delays and Chinese structural changes are part of the agreement. However, existing tariffs continue to weigh on Chinese exports, with November data showing a 1.1% y/y decline, and exports to the U.S. falling 23% y/y to $35.6B. Bloomberg estimates have GDP growth slowing from 2019's 6.1% y/y to 5.9% y/y in 2020.




**Japan – Surprising growth**
Final Q3 GDP growth soared to 1.8% q/q, compared to a preliminary reading of just 0.2% q/q as corporate investment and household consumption were stronger than initially reported. Several Bank of Japan committee members have stated more monetary policy easing is appropriate. Domestic demand for imported goods continues to slump following an October sales tax hike; imports fell 15.7% y/y in November.

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

# Market scorecard

| Index (local currency) | Level | 1 month | YTD | 12 month |
|---|---|---|---|---|
| S&P 500 | 3,230.78 | 2.9% | 28.9% | 28.9% |
| Dow Industrials (DJIA) | 28,538.44 | 1.7% | 22.3% | 22.3% |
| NASDAQ | 8,972.60 | 3.5% | 35.2% | 35.2% |
| Russell 2000 | 1,668.47 | 2.7% | 23.7% | 23.7% |
| S&P/TSX Comp | 17,063.43 | 0.1% | 19.1% | 19.1% |
| FTSE All-Share | 4,196.47 | 3.2% | 14.2% | 14.2% |
| STOXX Europe 600 | 415.84 | 2.1% | 23.2% | 23.2% |
| EURO STOXX 50 | 3,745.15 | 1.1% | 24.8% | 24.8% |
| Hang Seng | 28,189.75 | 7.0% | 9.1% | 9.1% |
| Shanghai Comp | 3,050.12 | 6.2% | 22.3% | 22.3% |
| Nikkei 225 | 23,656.62 | 1.6% | 18.2% | 18.2% |
| India Sensex | 41,253.74 | 1.1% | 14.4% | 14.4% |
| Singapore Straits Times | 3,222.83 | 0.9% | 5.0% | 5.0% |
| Brazil Ibovespa | 115,645.30 | 6.8% | 31.6% | 31.6% |
| Mexican Bolsa IPC | 43,541.02 | 1.7% | 4.6% | 4.6% |
| **Bond yields** | **12/31/19** | **11/30/19** | **12/31/18** | **12 mo. chg** |
| US 2-Yr Tsy | 1.569% | 1.612% | 2.488% | -0.92% |
| US 10-Yr Tsy | 1.918% | 1.776% | 2.684% | -0.77% |
| Canada 2-Yr | 1.697% | 1.586% | 1.863% | -0.17% |
| Canada 10-Yr | 1.702% | 1.463% | 1.967% | -0.27% |
| UK 2-Yr | 0.545% | 0.544% | 0.752% | -0.21% |
| UK 10-Yr | 0.822% | 0.697% | 1.277% | -0.46% |
| Germany 2-Yr | -0.601% | -0.627% | -0.610% | 0.01% |
| Germany 10-Yr | -0.185% | -0.360% | 0.242% | -0.43% |
| **Commodities (USD)** | **Price** | **1 month** | **YTD** | **12 month** |
| Gold (spot $/oz) | 1,517.27 | 3.6% | 18.3% | 18.3% |
| Silver (spot $/oz) | 17.85 | 4.8% | 15.2% | 15.2% |
| Copper ($/metric ton) | 6,486.50 | 5.2% | 3.4% | 3.4% |
| Uranium ($/lb) | 20.90 | -0.5% | -12.6% | -7.7% |
| Oil (WTI spot/bbl) | 61.06 | 10.7% | 34.5% | 34.5% |
| Oil (Brent spot/bbl) | 66.00 | 5.7% | 22.7% | 22.7% |
| Natural Gas ($/mmBtu) | 2.19 | -4.0% | -25.5% | -25.5% |
| Agriculture Index | 273.20 | 4.6% | 6.3% | 6.3% |
| **Currencies** | **Rate** | **1 month** | **YTD** | **12 month** |
| US Dollar Index | 96.3890 | -1.9% | 0.2% | 0.2% |
| CAD/USD | 0.7698 | 2.2% | 5.0% | 5.0% |
| USD/CAD | 1.2990 | -2.2% | -4.7% | -4.7% |
| EUR/USD | 1.1213 | 1.8% | -2.2% | -2.2% |
| GBP/USD | 1.3257 | 2.6% | 3.9% | 3.9% |
| AUD/USD | 0.7021 | 3.8% | -0.4% | -0.4% |
| USD/JPY | 108.6100 | -0.8% | -1.0% | -1.0% |
| EUR/JPY | 121.7700 | 1.0% | -3.2% | -3.2% |
| EUR/GBP | 0.8459 | -0.7% | -5.9% | -5.9% |
| EUR/CHF | 1.0856 | -1.5% | -3.5% | -3.5% |
| USD/SGD | 1.3459 | -1.6% | -1.2% | -1.2% |
| USD/CNY | 6.9632 | -1.0% | 1.2% | 1.2% |
| USD/MXN | 18.9265 | -3.1% | -3.7% | -3.7% |
| USD/BRL | 4.0304 | -4.9% | 4.0% | 4.0% |

The S&P 500 clocked its best annual return since 2013, when stocks advanced 29.3%.

All global yields, with the exception of the German 2-year, fell in 2019 amid accommodative global central banks.

Oil saw its best year in the past three as oversupply concerns eased and heightened geopolitical risk gave prices a boost.

The Australian dollar strengthened in December amid an 8% rally in iron ore prices, one of Australia's major exports.

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 0.76 means 1 Canadian dollar will buy 0.76 U.S. dollar. CAD/USD 5.0% return means the Canadian dollar has risen 5.0% vs. the U.S. dollar during the past 12 months. USD/JPY 108.61 means 1 U.S. dollar will buy 108.61 yen. USD/JPY -1.0% return means the U.S. dollar has fallen 1.0% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 12/31/19.

# Research resources

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Distribution of Ratings - RBC Capital Markets, LLC Equity Research
As of December 31, 2019

| | | | Investment Banking Services Provided During Past 12 Months | |
|---|---|---|---|---|
| Rating | Count | Percent | Count | Percent |
| Buy [Top Pick & Outperform] | 765 | 51.97 | 225 | 29.41 |
| Hold [Sector Perform] | 625 | 42.46 | 127 | 20.32 |
| Sell [Underperform] | 82 | 5.57 | 5 | 6.10 |

**Ratings: Top Pick (TP):** Represents analyst's best idea in the sector; expected to provide significant absolute total return over 12 months with a favorable risk-reward ratio. **Outperform (O):** Expected to materially outperform sector average over 12 months. **Sector Perform (SP):** Returns expected to be in line with sector average over 12 months. **Underperform (U):** Returns expected to be materially below sector average over 12 months. **Restricted (R):** RBC policy precludes certain types of communications, including an investment recommendation, when RBC is acting as an advisor in certain merger or other strategic transactions and in certain other circumstances. **Not Rated (NR):** The rating, price targets and estimates have been removed due to applicable legal, regulatory or policy constraints which may include when RBC Capital Markets is acting in an advisory capacity involving the company.

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