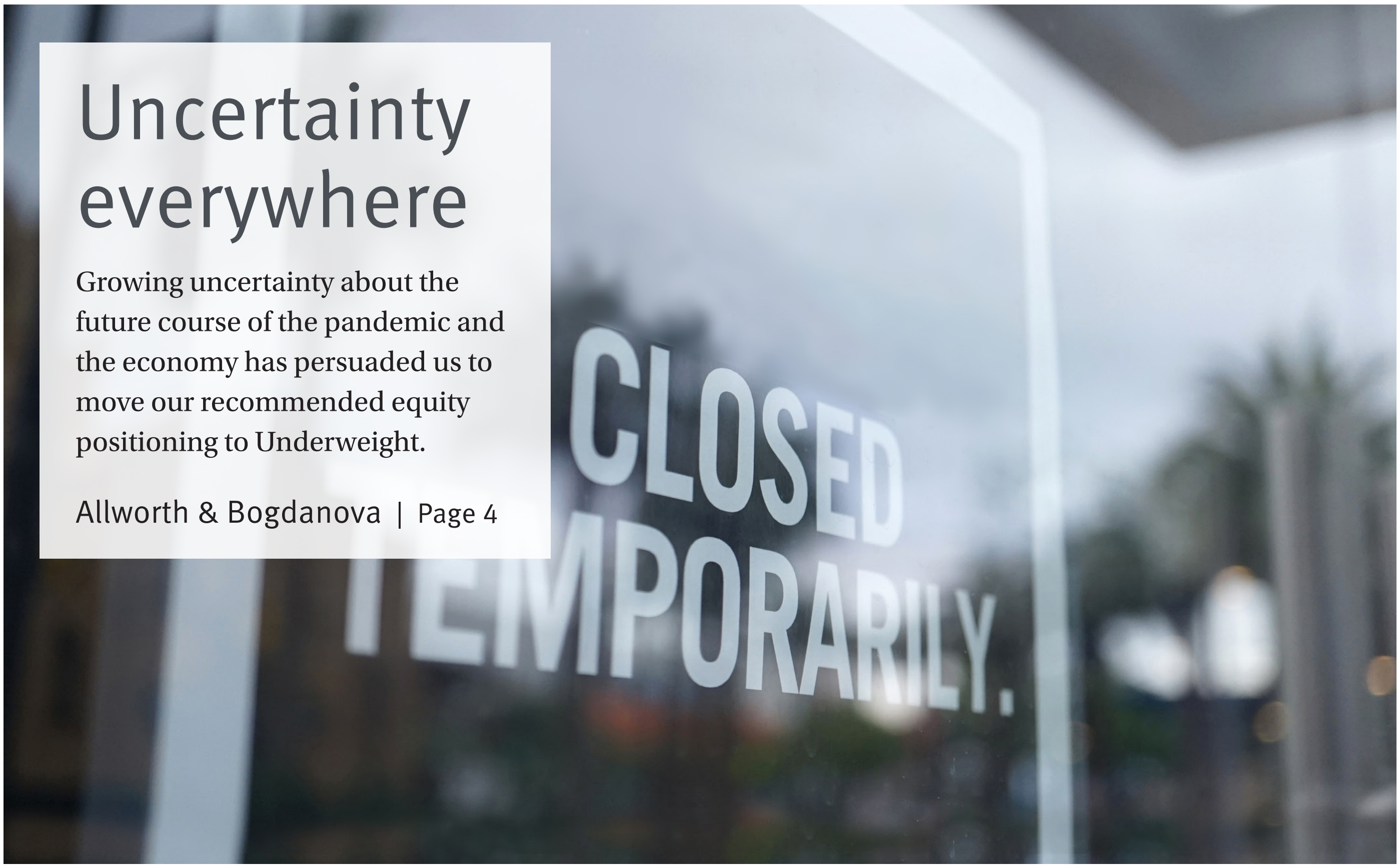
RBC WEALTH MANAGEMENT

# Global Insight

Perspectives from the Global Portfolio Advisory Committee




## Uncertainty everywhere

Growing uncertainty about the future course of the pandemic and the economy has persuaded us to move our recommended equity positioning to Underweight.

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**For important and required non-U.S. analyst disclosures, see page 27.**
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RBC Wealth Management

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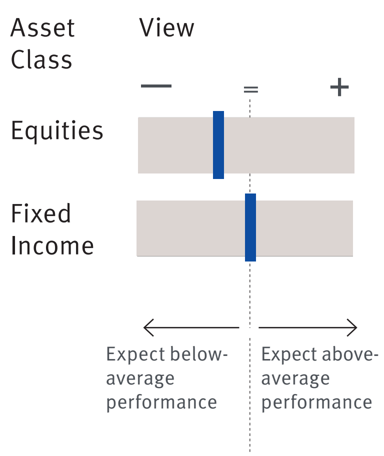
# RBC’s investment stance

### Global asset views




See “Views explanation” below for details

Source - RBC Wealth Management

## Equities

- Much uncertainty lingers regarding the current health care crisis. The full impact of lower activity levels worldwide is becoming apparent as economic indicators, and soon Q1 corporate earnings, are being released. They will make for grim reading over the next few months despite the colossal fiscal and monetary efforts. We expect volatility to remain heightened in the short term, as investors search for clues that the health care crisis is being alleviated.
- While we believe the recession will be temporary, and that the global economy and corporate earnings have the potential to begin recovering later in the year, there are numerous factors that could disrupt the eventual trajectory of the pandemic and economy. Therefore, we have moved our recommended global equity positioning to Underweight from Market Weight.

## Fixed income

- Treasury yields saw enormous swings over the course of March, but with the Federal Reserve stepping in to support markets, we think Treasury market volatility will subside. Though plenty of public health concerns and economic risks remain in the months ahead, current market conditions offer attractive risk/reward profiles across a number of fixed income sectors, with current valuations largely unseen for at least a decade.
- We maintain our Market Weight in global fixed income. Though global yields remain historically low, we think yields will steady around current levels. With markets already priced for a temporary recession, we upgrade high-yield corporates to Neutral, with a broad Overweight to credit.

## 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

# Uncertainty everywhere

**Jim Allworth**
Vancouver, Canada
jim.allworth@rbc.com

**Kelly Bogdanova**
San Francisco, United States
kelly.bogdanova@rbc.com

COVID-19 has overtaken our daily lives and brought parts of the economy to a standstill. In recognition of the pervasive uncertainty around the trajectory of both the pandemic and the economy, we are downgrading our stance on equities to Underweight. At the same time, we lay out the developments we are watching for that could put us back in an environment where future rewards considerably outweigh near-term risks.

- How soon the pandemic will begin to ebb and the economy return to normal remain open questions.
- Until some greater certainty arrives around the ability of the economy to rebound and a resumption of earnings growth, we believe share prices will remain vulnerable.

Hundreds of thousands of COVID-19 infections, tens of thousands of deaths—and climbing—and the world's largest economies and stock markets brought to their knees. This is no ordinary bear market.

There is little doubt to us that a global recession is unfolding and that no developed economy, including the U.S., will be spared. "Social distancing" intended to "flatten the curve" makes perfect sense when it comes to public health—the priority right now—but comes at great economic cost.

The economic news in the weeks and months directly ahead will be unsettling, to say the least. But our forecast has the effects of the epidemic waning in the second half of the year, permitting investors to focus their attention on the prospects for a resumption of stronger growth in 2021. The depth and duration of the equity correction will depend on how deep and for how long COVID-19 impacts North America and Europe as well as how effective fiscal and monetary stimulus measures prove to be.

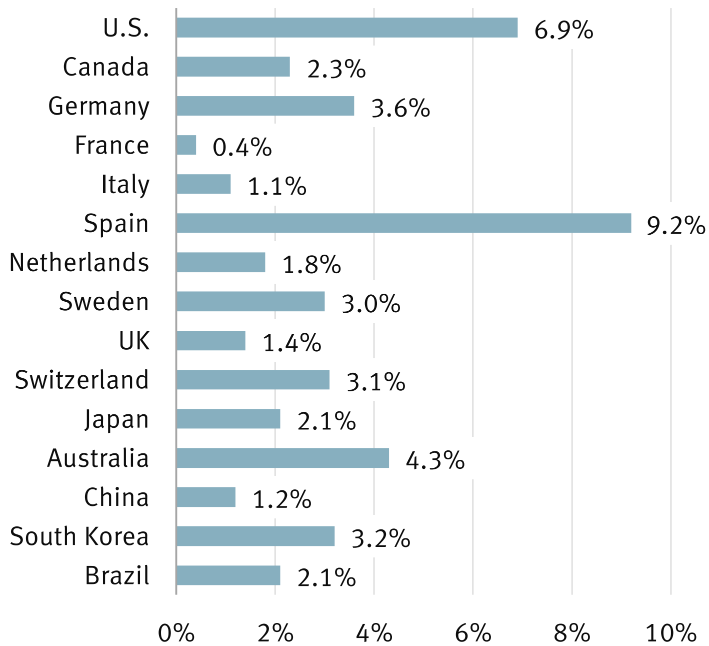
In recognition of how pervasive uncertainty is around the eventual trajectory of both the pandemic and the economy, we have moved our recommended global equity positioning to Underweight from Market Weight. We also set out the factors that we will have to see shift into a more positive reading to allow us to reinstate a fuller commitment to equities commensurate with the more constructive outlook we have for economic and earnings growth in 2021 and beyond.

## Go big

The massive fiscal aid and stimulus packages of the U.S., Canadian, and UK governments, along with most other developed countries, are designed to put a floor under economies during Q2 by keeping consumers and businesses financially viable through the period of maximum economic constriction.

### Global COVID-19 aid and stimulus packages thus far

Government outlay as a % of GDP




Governments have pledged significant funds to fight the crisis and combat the economic damage, and we think there is more to come.

Note: A new relief package that is still in the works is included in estimates for Japan. Fiscal stimulus only includes spending and tax cuts by governments, and does not include relief measures such as tax and fee deferral, loans, and loan guarantees.

Source - RBC Global Asset Management; data as of 3/27/20

We estimate the U.S. has committed aid of almost seven percent of GDP—a heretofore unheard of figure for the world's largest economy—while Germany and South Korea top three percent of GDP, and many other countries have committed substantial sums as well. Aggressive policies by all of the major central banks are also supportive.

Implicit in the aid and stimulus packages is the idea that infection rates and the number of daily new cases should be in decline in most countries well before Q2 ends, raising a realistic prospect of social and commercial conditions improving in Q3, with a more pronounced rebound evident in Q4. That is our expectation and operating forecast.

China has already demonstrated this is possible. The country was able to restart its economy within a few weeks of its infection rate (i.e., how many people one person with the virus is likely to infect) falling below one. South Korea, surprised by an explosive outbreak in late February, has pulled its daily new cases from close to 1,000 down to less than 100 in just a few weeks.

Italy's runaway epidemic is showing signs of slowing, and there are some improvements in Spain, which has also been hard hit. Should these nascent positive developments persist and occur alongside indications that social distancing elsewhere in Europe and North America is having a positive effect, the path forward would come into clearer view.

## The economic cost

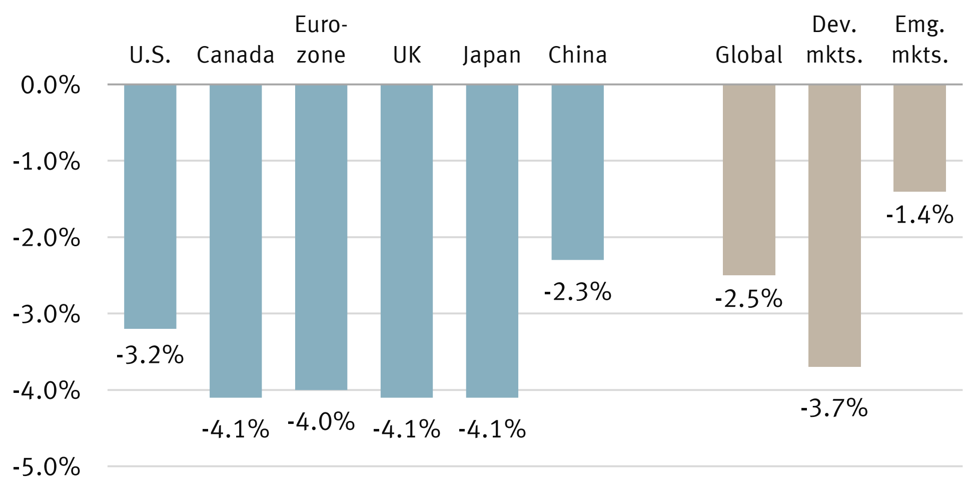
At this stage, we are estimating a disease trajectory for North America and Europe that has the number of COVID-19 cases peaking in April/May, then receding in May/June and throughout the summer.

Consistent with this pattern, RBC Global Asset Management Inc. Chief Economist Eric Lascelles anticipates the global economy will retrench by 2.5 percent in 2020 with much of the drag coming from developed economies, and emerging economies taking less of a hit.

For the U.S., Lascelles forecasts a 3.2 percent decline in GDP in 2020, down from his previous forecast of a 2.8 percent downturn when the spread of the virus was not as wide and its impact not as acute in the country. A 3.2 percent decline would represent a deeper recession than in 2009 during the global financial crisis, and the largest annual U.S. retrenchment since 1946. Incorporated into this annual contraction would be a severe 15 percent nosedive in Q2—the steepest drop of any quarter in U.S. history.

### RBC Global Asset Management's 2020 annual GDP growth forecasts

Annual average % change according to a medium-depth and medium-length recession scenario




Dev. mkts. = Developed markets; Emg. mkts. = Emerging markets

Source - RBC Global Asset Management; estimates as of 3/27/20

The economies of Europe and Canada are expected to shrink more than the U.S. in 2020—by about four percent—because of the severity of the disease in Europe and the additional blow of low oil prices in Canada. Japan is in the same boat in terms of economic impact.

Lascelles notes, however, that economies have the potential to recover quickly in the second half of this year because the hits to labor supply and product demand are largely due to “stay at home” and “work from home” government edicts being implemented for public health purposes, and can be rapidly reversed when the virus wanes.

For 2021, he sees the U.S. economy bouncing back sharply, with GDP rising 5.6 percent—the biggest annual increase since 1984, a recovery that followed a harsh double-dip recession.

## Opaque outlook

Our scenario of an April/May peak in the number of cases and quick economic recovery is only one of many potential outcomes. The “wishing and hoping” scenario—i.e., the pandemic peaks sooner, recedes faster—seems unlikely to materialize. The “slower to peak and to recede” version would deepen the economic impact and likely produce a fresh round of equity market volatility.

Two phases of the pandemic, with the second beginning this fall and carrying into next spring, would not be unusual from a historical perspective (the Spanish Flu had three waves). This raises the possibility that 2021 might experience another period of economic contraction.

None of these scenarios can be said to be the one most likely to occur, leaving the outlooks for the economy and corporate earnings very much in flux in the short term.

## Profit pressure

All of the economic pressure, of course, spills over into corporate profits. RBC Capital Markets believes it’s reasonable to expect S&P 500 earnings to decline by at least 15 percent this year from the 2019 level, with the biggest hits in Q1 and Q2. That would put 2020 earnings per share at $139, although we think there is downside risk to this forecast if the COVID-19 shutdowns linger for longer than just the next couple of months. (At the moment consensus forecasts remain unrealistically high at $164 from which they are likely to fall in coming weeks.)

It is worth remembering the “value” of an individual business and of the equity market as a whole is the present value of *all future earnings*—i.e., investors are buying into a multiyear stream of earnings. Looked at that way, even big, unexpected changes in the near-term earnings outlook shouldn’t have a large impact on the market value of corporations. But they usually do because, for a while, investors come to believe that the performance of the economy and market today are pointing to an altered trajectory for economic and earnings growth in the future.

Looking back at a century of pandemics, wars, nuclear disasters, and more, that sort of conclusion has not been useful. Within a year or two, the forces of global population growth and rising prosperity tend to reassert themselves and, before that has happened, stock markets have gone back to capitalizing future earnings appropriately.

We do not believe COVID-19 will cause a permanent hit to the profits of most companies. Not even the Spanish Flu of 1918—a much more deadly pandemic that killed more than 40 million mostly young adults worldwide with three rounds of mass infection—resulted in enduring damage to economic growth.

But right now, deep uncertainty is present on several fronts. Earnings estimates and GDP forecasts everywhere are being revised lower in response to the near standstill in some parts of the economy. Price-to-earnings (P/E) multiples have been pressured lower as: (1) investors have become more pessimistic about future economic prospects and (2) ultralow corporate bond yields, which were supportive of above-average P/E multiples, have been swiftly replaced by much higher yields—Moody’s Baa yields rose from 3.20 percent on Mar. 9 to about 4.60 percent—offering a more attractive return alternative to stocks than just a few weeks ago.

While it’s true the swift 35 percent peak-to-recent-trough decline in most stock markets priced in much of this uncertainty, it’s also the case, in our view, that the tide of bad news has not yet turned, leaving open the possibility of further market weakness to come.

Here are some of the developments we are watching for that could potentially put us back in an environment where future rewards considerably outweigh near-term risks:

- Arrival of a clear peak in the number of daily new cases in the developed economies, but particularly in the U.S., together with a drop in the infection rate to levels (less than one) indicating that the spread was under control and diminishing.
- The identification of an agreed short list of vaccine candidates where indications of efficacy are good, and a testing start date is determined.
- The arrival of positive test results for some of the many anti-viral therapies under consideration.

- An exponential increase in the availability of test kits and facilities, both for rapid detection of new infections and for detection of the presence of anti-bodies, implying immunity. Both are key to gauging the advisability of easing/lifting travel and social restrictions.
- Indications that fiscal measures are having the desired effect.
- Some retreat in corporate bond yields that would take pressure off P/E multiples.

### Less now, more later

In recognition of how pervasive uncertainty is around the eventual trajectory of both the pandemic and the economy, we have moved our recommended global equity positioning to Underweight from Market Weight. However, we expect some combination of an easing in the progress of the pandemic and signs the policy responses are having the desired effect will eventually allow the market to regain its composure by permitting investors to focus on improving prospects for 2021.

Focus article

# A state of suspended animation

**Thomas Garretson, CFA**
Minneapolis, United States
tom.garretson@rbc.com

The Fed is leaving no stone unturned as it seeks to revive the economy's feeble pulse and keep markets functioning. We look at the what, the why, and the how of the Fed's line of attack against COVID-19. And with the Fed adding a new twist to its asset purchase program by buying corporate and municipal bonds, the question is, should investors do the same?

- The Fed has broken the glass on policy tools not used since the financial crisis to ensure that markets operate smoothly amid heightened economic uncertainty.
- In order to build a bridge over the economic gulf created by COVID-19, the Fed has also introduced new tools to support the flow of credit to households and businesses.
- Though risks remain, market volatility has created opportunities rarely seen for investors over the past 30 years.

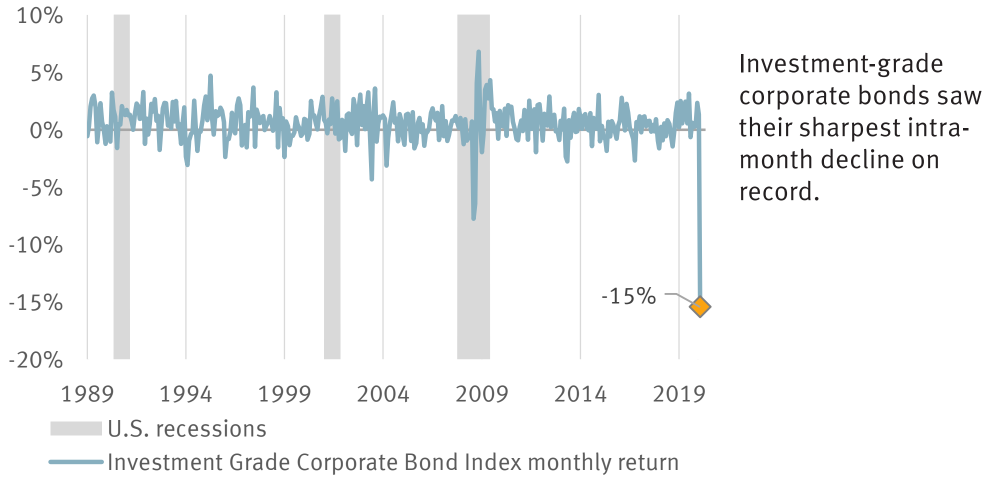
As global governments place economies into necessary states of suspended animation in order to slow activity and to minimize the public health and economic toll of COVID-19, global central banks have pulled out all of the stops—and many of the tools from the global financial crisis—to ensure that markets don't also enter the same states of slowing, or even stopping.

With respect to the U.S. market and the Fed, it has largely focused on providing liquidity, the lifeblood of financial market function, via a renewed quantitative easing program that is now effectively limitless—meaning that the Fed will buy Treasuries and mortgage-backed securities (MBS) as it sees fit until markets are "operating smoothly." Since announcing plans to ramp up asset purchases at the beginning of March, the Fed has been buying at such a furious pace that its balance sheet has already expanded by over $1 trillion, taking it beyond the $5 trillion level for the first time.

But while buying Treasuries and MBS is the same thing the Fed did in the aftermath of the global financial crisis during its three quantitative easing programs, the new angle is that the Fed is making its first foray into buying bonds beyond government securities, by expanding its scope to corporate and municipal bonds.

It has moved to do so because of sharp dislocations and illiquidity due to forced selling as investors fled numerous bond funds, while the economic and credit risks posed also caused significant repricing. As the chart below shows, at the nadir in March, investment-grade corporates had declined by 15 percent, eclipsing even the worst months of the global financial crisis.

Volatility hits corporate bond markets




Source - RBC Wealth Management, Bloomberg Barclays US Investment Grade Corporate Bond Index

## Lender of last resort

Though there are plenty of details still to be worked out, there was roughly $450 billion as part of the $2 trillion CARES Act set aside for the Treasury Department to backstop lending by the Fed. The thinking is that the Fed would be able to leverage that amount by about 10 times, which could create more than $4.5 trillion of financing power to buy the debt of various borrowers, which would include corporations and municipalities. To put that number in perspective, it would constitute almost a third of the outstanding debt of U.S. investment-grade corporations and municipalities, which comes to approximately $8 trillion and $4 trillion, respectively.

So that’s the “what” and “why” of the Fed’s actions, here’s a quick snapshot of the “how”:

**Primary Market Corporate Credit Facility:** We can think of this lending facility as addressing the “cash crunch” problem for large companies by lending directly to businesses, ensuring their access to credit. Terms will be for less than four years, loans will be open to companies rated investment-grade by the major ratings agencies, and companies will have the option of delaying interest and principal payments for six months, but will then be prohibited from buying back shares for a period of time.

**Secondary Market Corporate Credit Facility:** This facility helps to address market functioning issues that plagued markets throughout March, with the Fed not only purchasing outstanding bonds but also shares of exchange-traded funds (ETFs), providing another source of market liquidity. The terms are the same as the Primary Market Corporate Credit Facility, but with a maximum of five years remaining to maturity. The Fed would be able to buy a maximum of 10 percent of any single issuer's outstanding bonds, and up to 20 percent of any ETF with a broad U.S. investment-grade corporate bond mandate.

**Main Street Business Lending Program:** The Fed is also focused on making credit available to small and medium-sized businesses that will be administered alongside the Small Business Administration, though details are forthcoming.

These programs should be up and running in the first half of April, according to Fed plans. And while we await further details, the challenge, in our view, will be how the Fed plans to go about buying without "playing favorites," particularly in the highly fractured muni market. With respect to corporates, any company that receives bailout money from other government programs would be excluded.

While the government stimulus packages are aimed at getting people through these challenging times and temporary job losses, the Fed's efforts of providing credit and liquidity are aimed at bridging the gap for companies to ensure that workers have businesses to return to.

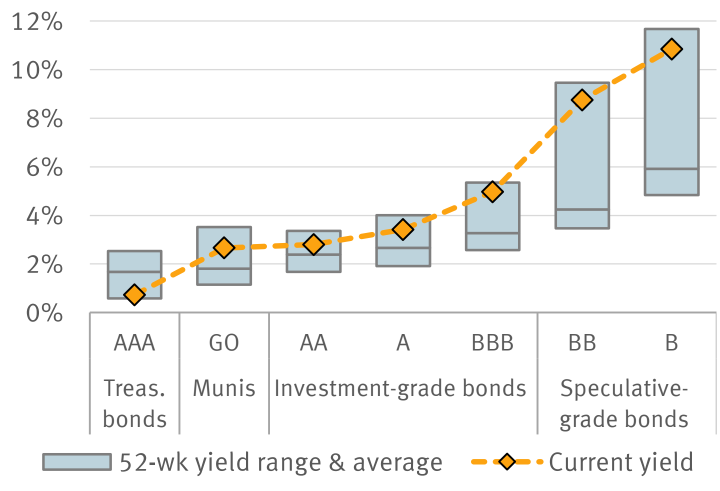
## Credit where credit is due

Even though the economic and recession risks posed by the COVID-19 outbreak are virtually unprecedented, the credit risks posed to companies are the same as they usually are—it's a matter of liquidity, not solvency. That partly explains why the Fed is focusing on buying short-dated securities maturing in less than five years, and directly lending to companies: as long as firms have access to liquidity, they should be able to manage short-term disruptions to revenues and earnings.

But moving to broader markets, as the chart on the following page shows, the riskiest speculative-grade firms are most at risk, where yields have jumped beyond 10 percent, a level historically associated with distress. The long-feared risks around BBB-rated companies and potential downgrade risks have also reemerged, with the average yield on a Bloomberg Barclays index of BBB-rated companies in excess of five percent, the highest since 2009 as markets reprice for greater risks ahead.

As a result, ratings agencies have sprung into action. "Fallen angels," or companies that have lost their investment-grade rating and have been downgraded into speculative-grade territory by Standard & Poor's have already swelled to 19 through the end of March, the fastest quarterly pace since the energy downgrade wave in early 2016.

U.S. fixed income yields remain near decade highs




Market volatility has pushed yields toward recent—and decade—highs.

Source - RBC Wealth Management, Bloomberg Barclays Bond Indexes

To be sure, the Fed currently only has plans to purchase the debt of investment-grade companies. On the one hand, that may separate the haves and the have-nots, but on the other hand, it could incentivize companies with investment-grade ratings to take steps to defend their balance sheets and ratings.

But if the Fed looks set to start buying in the corporate and municipal bond markets, should investors do the same?

## Opportunity knocks

"Don't fight the Fed" was the common refrain in the years that followed the global financial crisis, and now with the Fed returning in an even bigger way—does that mantra still hold true?

Fixed income investors have been beset by years of historically low yields and relative market stability that have limited entry points into bonds at what we would view as attractive valuations. Credit investors look at credit spreads, or the excess yield over risk-free Treasuries that investors demand for perceived credit risks, in order to assess what they're being paid to take on those risks. And with extremely elevated levels of market volatility, we are starting to see early signs of opportunity for credit investors, and at levels rarely seen as we think markets have already priced for a short-term recession.

As the table on the next page shows, investment-grade corporate credit spreads peaked at 3.7 percent in March, which falls within the three percent to four percent range, as highlighted. These types of valuations have only occurred for a total of 13 weeks dating back to 2000. And based on historical averages, investment-grade bonds have gone on to return approximately 15 percent over the following 12 months. We believe the prospects for high-yield corporates could be even better for

Current corporate bond valuations are favorable for investors

| U.S. investment-grade corporates | | | U.S. high-yield corporates | | |
|---|---|---|---|---|---|
| Credit spread range | Next-12-month avg. total return | Weeks in range | Credit spread range | Next-12-month avg. total return | Weeks in range |
| 0%–1% | 3% | 210 | 0%–2.5% | -2% | 8 |
| 1%–2% | 6% | 606 | 2.5%–5% | 5% | 488 |
| 2%–3% | 7% | 108 | 5%–7.5% | 7% | 339 |
| **3%–4%** | **15%** | **13** | 7.5%–10% | 17% | 97 |
| 4%–5% | 21% | 11 | **10%–12.5%** | **33%** | **10** |
| 5%–6% | 24% | 19 | 12.5%–15% | 50% | 12 |
| ›6% | 27% | 4 | ›15% | 61% | 17 |
| **Totals:** | **6%** | **971** | **Totals:** | **8%** | **971** |

Note: Shaded regions show average spread range during March 2020; calculations based on weekly data from August 2000 to March 2019. Source - RBC Wealth Management, Bloomberg Barclays Indexes

investors with the appropriate risk appetite. Based on the same data, the current index yield advantage over Treasuries peaked at 11.0 percent in March; the sector on average tends to return over 30 percent in the 12 months that follow.

While plenty of uncertainty and risks remain, the risk/reward profiles across a wide swath of the U.S. fixed income markets have rarely been more favorable for credit investors, in our view. With the Fed on deck to begin buying corporate and municipal bonds, we think investors should do the same.

# Regional equity

In recognition of the pervasive uncertainty around the trajectory of both the pandemic and the economy, we are downgrading our stance on global equities to Underweight. For a full account of our thinking, see the "Uncertainty everywhere" article on page 4.

## Regional highlights

United States

- With the coronavirus black swan having landed on the U.S. equity market, the economic and profits outlooks are the most uncertain since the global financial crisis. We think a recession is inevitable given much of the day-to-day activity in the country has come to a halt.
- As a result, RBC Capital Markets has further cut its S&P 500 earnings estimate to $139 per share from $165 (it had been at $174 before the health crisis surfaced). The new estimate equates to a 15% year-over-year decline versus the $163 level achieved in 2019, as measured by FactSet. It assumes two quarters of negative GDP growth, with the biggest hit coming in Q2.

### Equity views

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

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

- In the near term, the market has to contend with a difficult Q1 earnings reporting season as management teams disclose the impact of the crisis on operations thus far and attempt to assess Q2. Over the longer term, we expect the economy and corporate profits to move out of this valley and bounce back. The massive $2.2 trillion federal aid package and the aggressive and resolute initiatives by the Federal Reserve should help blunt the downturn and hasten the recovery.
- The depth and duration of the equity correction will depend on how deep and for how long the coronavirus

**Jim Allworth**
Vancouver, Canada
jim.allworth@rbc.com

**Kelly Bogdanova**
San Francisco, United States
kelly.bogdanova@rbc.com

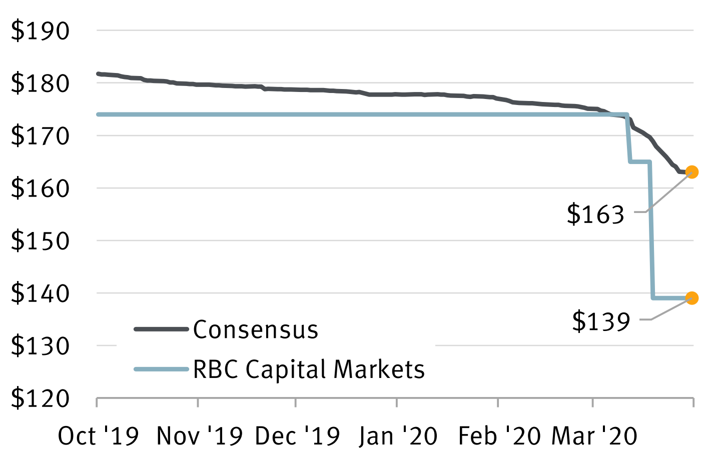
**Patrick McAllister, CFA**
Toronto, Canada
patrick.mcallister@rbc.com

**Frédérique Carrier**
London, United Kingdom
frederique.carrier@rbc.com

**Jasmine Duan**
Hong Kong, China
jasmine.duan@rbc.com

### 2020 EPS estimates fall sharply on COVID-19

S&P 500 2020 EPS estimates over 6 months




Source - RBC Wealth Management, FactSet; data through 3/31/20 impacts the U.S. We think patience will be an important virtue in 2020.

### Canada

- The Canadian equity market underperformed global benchmarks during the worst of the virus-induced selloff as a dramatic decline in crude oil compounded the domestic benchmark's woes. The S&P/TSX Composite Index now trades at a forward price-to-earnings multiple of 13.5x relative to its long-term average of 15.5x. Despite this seemingly compelling valuation, we expect consensus earnings estimates to remain in flux with the potential for further downward revisions.

- The dual shocks of a price war and virus-related disruptions have thrust the oil market into a period of unconstrained supply and subdued demand. The resulting low prices have made balance sheet preservation the top priority for the industry. Capital budgets have been slashed, and a number of companies have already cut their dividends. Should energy prices remain depressed for a protracted period of time, even the largest and best-capitalized companies could be forced to cut their dividends.

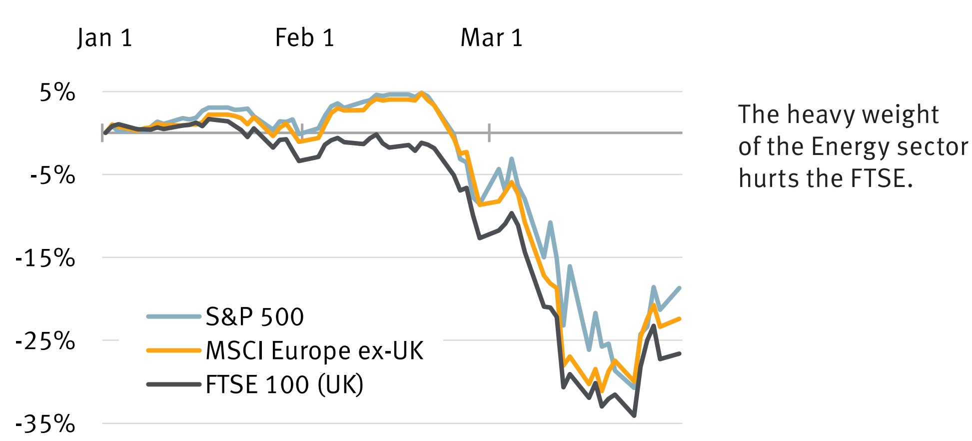
- The Canadian banks' direct lending exposure to the oil & gas industry is manageable, but the wide-ranging impacts of COVID-19 suggest to us that the domestic economy is already in recession and credit losses could be broad-based. The banks are well-capitalized and dividends are sustainable under a range of potential downside scenarios. However, while dividend yields look attractive, bank investors must be willing and able to endure further volatility.

### Continental Europe & UK

- We retain Market Weight recommendations for Europe and UK equities—for now. With the epicenter of coronavirus having moved to Italy and spreading throughout the continent, the European Central Bank (ECB) and national fiscal authorities stepped in with sweeping measures to support markets and the various economies. The ECB declined to move interest rates further in negative territory, but provided the banking system with a large support package. Eurozone member states put together fiscal measures of some 15% of GDP on average. From its all-time high reached in February to the health-care-crisis-

#### The UK lags Europe and the U.S. despite its historical "defensive" status

S&P 500 2020 EPS estimates over 6 months




Source - RBC Wealth Management, FactSet; data through 3/30/20 driven trough in March, the STOXX Europe 600 ex UK Index fell close to 35%, in line with the S&P 500's fall over the same period.

- With most of the region now in lockdown, economic activity has come to a standstill. A recession is clearly to be expected—how long it lasts will depend on the eventual lifting of confinement measures.
- UK equities didn't live up to their reputation as being defensive, and fell by a similar amount, despite a 12% fall in the currency. Historically, a lower pound has lifted UK equities, a large proportion of which are exporters. Concerns about the UK falling onto unfavourable World Trade Organization trading terms at the end of the year should the government not request an extension to the transition period, combined with the initially indecisive handling of the coronavirus crisis, made for an unpalatable cocktail for investors. We think opportunities are arising for quality multinational companies that sold off excessively.

### Asia

- China's economic recovery following the country's coronavirus crisis may be held back by weaker global demand. Around 85%–90% of Chinese companies have resumed work, but many are facing order cancelations from overseas markets. Significant declines over the first two months of the year compared to consensus estimates for industrial production (-13.5% y/y versus -3%), retail sales (-20.5% y/y versus -4%) and fixed asset investment (-24.5% y\y versus -2%) as tracked by Bloomberg suggest China's Q1 GDP growth may be heading for a deep negative reading. Infrastructure spending may still be a key driver of the country's GDP growth this year: about RMB40 trillion of investment has been committed by 31 provinces, including traditional infrastructure projects and "new infrastructure" such as 5G networks, big data centers, and urban mass transit. The good news is that China's central bank still has ample monetary tools to support the economy, including the ability to trim the required reserve ratio and to cut bank funding costs and loan pricing.
- The Bank of Japan (BoJ) introduced more measures to curb the economic impact of Covid-19. Key changes included doubling the central bank's annual purchase limits for ETFs and J-REITs to JPY12 trillion and JPY180 billion, respectively. Historically, P/E multiples for Japanese equities have tended to expand when the BoJ has increased its ETF buying facility; however, the effect has been smaller with each new increase in ETF purchases. The central bank has also, unexpectedly, kept short-term interest rates unchanged. Market participants believe the 100 USDJPY currency exchange mark will be a key level to watch as the BoJ determines its interest rate strategy. With the TOPIX trading at valuations below the global financial crisis trough and the BoJ supporting the market, we believe there will be some form of support for Japan equities in the near term.

# Know no limits

During these unprecedented times, central banks have largely turned to policy tools with at least some form of precedence from the global financial crisis, but with one key difference—now there are no limits.

March was notable not just for the speed with which global central banks reacted, but also by the magnitude. The Fed and the European Central Bank were the first to restart or increase asset purchase programs, both north of $700 billion, but those targets were discarded almost as quickly as they were announced with both banks pledging to buy as needed to support markets. In addition to quantitative easing programs, the primary focus of central banks has been to establish lending facilities to support the flow of credit to households, businesses, and financial markets.

With respect to the Fed, officials announced the first foray into the corporate bond market, initiating programs to buy investment-grade bonds in the primary market directly from issuers, as well as in the secondary market, including exchange-traded funds with investment-grade corporate mandates, in order to support liquidity.

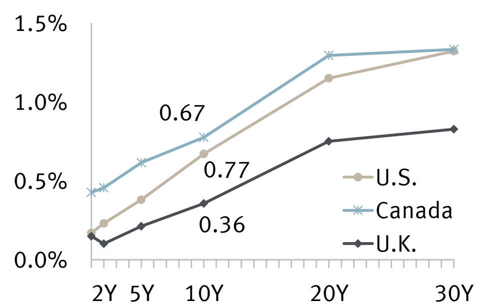
With seemingly unlimited firepower from major central banks, along with increasing fiscal responses from global governments, we believe risk assets such as corporate bonds should find support from the massive injections of liquidity and stimulus, with current valuations already offering what we view as attractive entry points given that markets have repriced for the likelihood of a temporary global recession.

### 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 3/31/20

But the outlook for sovereign yields might be less clear. On the one hand, massive central bank bond-buying programs will serve to drive up bond prices, and yields down, while plenty of concerns about the economic outlook will likely keep a lid on yields.

On the other hand, if effective, all of this stimuli should provide a massive tailwind for growth and inflation as the worst of the viral outbreak passes, compounded by what we think will need to be significant increases in bond issuance to finance what will be significant—though somewhat temporary—deficits

**Tom Garretson, CFA**
Minneapolis, United States
tom.garretson@rbc.com

**Christopher Girdler, CFA**
Toronto, Canada
christopher.girdler@rbc.com

**Alastair Whitfield**
London, United Kingdom
alastair.whitfield@rbc.com

**Chun-Him Tam**
Singapore
chunhim.tam@rbc.com

For now, we think the scale is roughly balanced and that sovereign yields will find ranges around current levels as central banks bring back stability, with the next direction dictated by the depth and duration of the economic and public health crisis created by COVID-19.

## Regional highlights

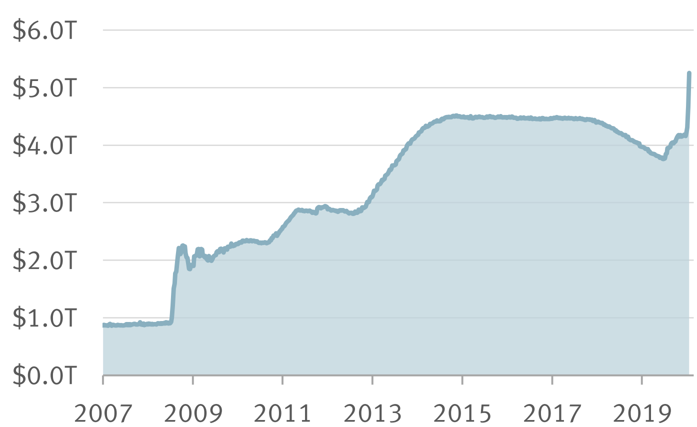
United States

- The Fed pulled out all of the stops over the course of March, dusting off much of the global financial crisis playbook in terms of market backstops and lending facilities, but the biggest pledge came in the form of "unlimited" asset purchases of Treasuries and mortgage-backed securities across all maturity dates in order to support "smooth market functioning." The key is that the Fed's actions to this point have largely been aimed at market liquidity. The Fed still has room to pivot its "unlimited" asset purchases toward longer-dated Treasuries in an effort to drive real yields lower, while possibly expanding the scope to include direct purchases of municipal and corporate bonds, should market and economic conditions warrant it.
- Corporate bonds had one of their worst months on record as investment-grade corporates dropped by 7% and high-yield corporates by 11%, while risk-free Treasuries returned 3%. Credit spreads, or the additional yield demanded by investors for credit and default risks, hit their highest levels since the financial crisis as recession risks have grown. However, with the tailwinds of enormous Fed and government fiscal support, and with credit markets now priced for what we believe will be a short-lived recession, we think investors with appropriate risk appetites can enter into corporate bonds at valuations and yields not seen in nearly a decade.
- The market liquidity crunch drove $17 billion of muni fund outflows, creating dislocations across the sector, pushing muni yields north of 3.5%, the highest since 2011. There are signs the muni market is stabilizing, and that current valuations may entice investors to re-enter the market.

Canada

- The Canadian government bond market has provided some defence against the sudden drop in equity indices but, unfortunately, not enough. The Bank of Canada reduced its policy rate by 100 basis points—via two separate 50 basis points cuts—last month, sending Government of Canada yields to record lows. Given the bond market

Fed expands balance sheet at unprecedented rate




The Federal Reserve's balance sheet ballooned to new highs on extraordinary actions in March.

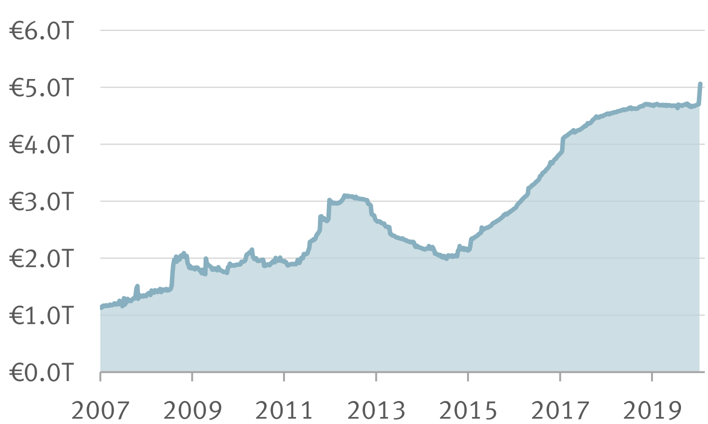
Source - RBC Wealth Management, Bloomberg; data through 3/25/20 was already priced for the policy rate to head towards zero, the latest losses experienced by equity indices have not been accompanied by higher government bond prices.

- The biggest pain for fixed income holders has come via corporate bonds and preferred shares. Market liquidity evaporated quickly, and investors have been left scrambling for safety, pushing risk premiums to the widest levels of this decade. Central banks providing unprecedented levels of liquidity to restore confidence and reduce volatility is beginning to have some success as risk premiums have begun to reduce and companies have begun re-issuing debt after a hiatus.
- Market dislocations often breed opportunities and this is the case today for clients who have cash or are in a position to sell government bonds. We are recommending taking profits on Government of Canada positions and rotating into corporate bonds that have cheapened significantly in this selloff. Some exchange-traded funds have been trading at discounts to their quoted Net Asset Values though we are not recommending investors sell existing corporate bonds to fund these positions. Given poor market liquidity, we think only cash buyers or holders of federal bonds should consider these opportunities.

### Continental Europe & UK

- Fixed income markets in Europe and the UK have shifted considerably in recent weeks, as the COVID-19 pandemic caused governments and central banks to take significant action to support their economies. Yields across the board sank to new lows and credit spreads widened markedly.
- European Central Bank (ECB) President Christine Lagarde laid out her own "Whatever It Takes" initiative to control the impact on the euro area economy, providing support to governments, companies, and the banking system. While the deposit rate has not been lowered from the current -0.5%, the ECB announced a new pandemic emergency purchase programme of €750 billion for the remainder of 2020. This equates to up to €80 billion per month, the peak level of the previous programme, and will now include both commercial paper of non-financial corporates as well as Greek government bonds. Also, euro area banks will be able to benefit from further liquidity being provided at the deposit rate of -0.5%.
- In the UK, the Bank of England has cut interest rates to just 0.1%, with

### Cash demand causes ECB balance sheet to soar to new heights




The ECB's balance sheet has expanded almost €230 billion amid massive cash demands.

Source - RBC Wealth Management, Bloomberg; data through 3/27/20 its quantitative easing programme increased by £200 billion covering both government and corporate bonds. Further measures included a four-year term funding scheme for small and medium companies.

- We see these measures, coupled with the action plans of both the UK and European national governments, as being supportive over time to markets.
- For now, our recommendations are unchanged. We retain our Market Weight on European government bonds and modest Overweight in European corporate credit. We maintain our Underweight on UK government bonds, targeting the 3- to 5-year duration bucket, and Market Weight on UK corporate credit.

### Asia

- We entered 2020 with a positive bias on Asia high-yield bonds but reduced our position at the end of January as the extent of the COVID-19 outbreak in Asia became worrying. The more defensive positioning proved prudent as the credit risk premium has increased sharply since then.
- The dislocation in credit markets during March was more severe than that which occurred during the global financial crisis in 2008. The yield on the Bloomberg Barclays Asia High Yield Bond Index moved from 6.6% to 11.9% in Q1, with a big jump towards end-March. By contrast, the Asia investment-grade space demonstrated its resilience with yields rising from 3.0% to just 3.2%, contained in part by lower U.S. Treasury yields.
- From a valuation perspective, Asia high-yield bonds are starting to look attractive. We believe current bond yields have already priced in a lot of credit stress and provide adequate risk/reward for aggressive investors. While volatility remains high and additional correction is possible, we also acknowledge that a recovery could be swift when it comes.
- The COVID-19 situation appears to be improving in China. We take comfort in the Chinese government's ability and willingness to support the market. We believe China has plenty of monetary and fiscal power to draw upon if needed, especially compared to the developed economies. It is also worth noting that China's onshore bond market is approximately 10 times larger than its offshore one, which is key to ensuring that Chinese issuers have access to funding.

## Commodities

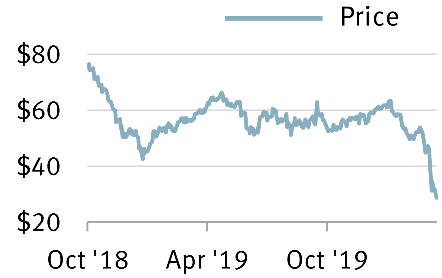
### Commodity forecasts

| | 2020E | 2021E |
|---|---|---|
| Oil (WTI $/bbl) | $37.61 | $42.00 |
| Natural Gas ($/mmBtu) | $2.15 | $2.40 |
| Gold ($/oz) | $1,520 | $1,450 |
| Copper ($/lb) | $2.70 | $2.75 |
| Soybean ($/bu) | $9.07 | $9.35 |
| Wheat ($/bu) | $5.15 | $4.92 |

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

**WTI – New lows**

Global oil prices have collapsed on the heels of Russia opting not to participate in Saudi Arabia's proposed 1.5 million bbl/day production cut. In response, Saudi Arabia boosted production by 2.5 million bbl/day and cut prices. All producers will have to revisit capital allocation priorities in order to weather the storm, in our view. RBC Capital Markets analysts decreased their 2020 forecast to $37.61/bbl (from $59.32/bbl).

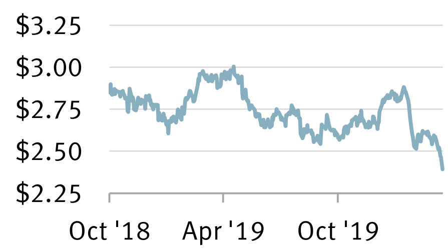



**Natural gas – Lower for longer**

While falling oil production should reduce associated natural gas production in North America, this is somewhat offset by above-average storage levels. The demand side of the equation has also been dampened as the impact of COVID-19 begins to filter through industrial, power, and LNG-related demands. Prices are trading at the bottom end of the 18-month range. RBC Capital Markets analysts have revised their 2020 forecast to $2.15/mmBtu (from $2.25/mmBtu).

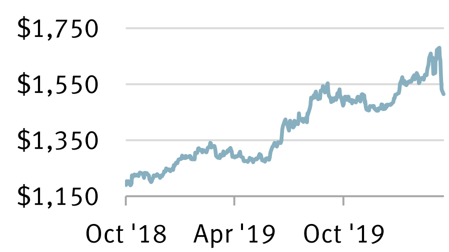

**Copper – Duties exemption**

Copper prices have declined by approximately 23% year to date as COVID-19 has materially slowed GDP growth in China, which accounts for about 8% of global supply and roughly 50% of refined copper demand. China announced select U.S. copper scraps and concentrates will be exempt from duties, which could support higher imports into China, in our view, since some domestic production has been suspended.



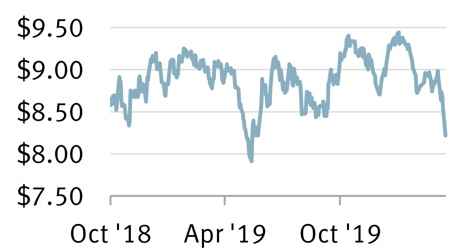

**Gold – Still constructive**

Gold outperformed equity markets both in the decline and recovery. The weakest point, in the view of RBC Capital Markets commodity strategists, came when investors may have trimmed gold positions in order to cover margin calls and losses in other markets. We remain constructive on gold given the accommodative backdrop of persistently low real rates and heightened volatility within the broader markets, as well as the lack of any significant new supply.



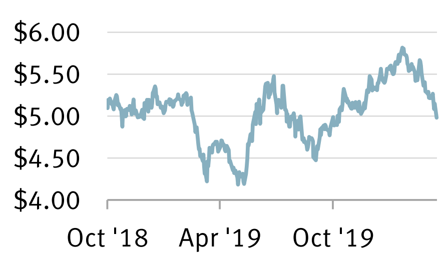

**Soybeans – Degree of support**

Soybean pricing declined by 8% year to date driven by the risk-off environment, and the commodity is trading above its 18-month low of roughly $7.90/bushel. We believe pricing should find a degree of support following Chinese data that suggests weekly soybean inventories have fallen sharply to 2010 lows. Fundamentals remain constructive, in our view, but a stronger U.S. dollar may be a headwind.




**Wheat – Lower record**

Wheat prices fell below $5/bushel but managed to bounce back to January 2020 levels. The USDA revised its 2019/20 global outlook for higher production, increased consumption, and lower ending inventories. While the ending inventory estimate has been trimmed, the 2019/20 crop year is still on pace to end with a record high of roughly 287 million tonnes on hand, with the bulk held by China.




Source - RBC Wealth Management, Bloomberg; date range: 10/1/18–3/16/20

**Richard Tan, CFA**
Toronto, Canada
richard.tan@rbc.com

# Currencies

## Currency forecasts

| Currency pair | Current rate | Forecast Mar 2021 | Change* |
|---|---|---|---|
| Major currencies | | | |
| USD Index | **99.45** | 93.48 | -6% |
| CAD/USD | **0.70** | 0.73 | 4% |
| USD/CAD | **1.41** | 1.37 | -3% |
| EUR/USD | **1.09** | 1.17 | 7% |
| GBP/USD | **1.23** | 1.23 | 0% |
| USD/CHF | **0.96** | 0.90 | -6% |
| USD/JPY | **107.79** | 97.0 | -10% |
| AUD/USD | **0.61** | 0.65 | 7% |
| NZD/USD | **0.59** | 0.62 | 5% |
| EUR/JPY | **118.26** | 113.0 | -4% |
| EUR/GBP | **0.88** | 0.95 | 8% |
| EUR/CHF | **1.05** | 1.05 | 0% |
| Emerging currencies** | | | |
| USD/CNY | **7.08** | 6.90 | -3% |
| USD/INR | **75.54** | 72.50 | -4% |
| USD/SGD | **1.42** | 1.38 | -3% |

* 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: Charging ahead

The U.S. dollar has emerged as a key benefactor of the recent market volatility, posting impressive gains against all G-10 currencies since the coronavirus outbreak began. As concerns on market liquidity and dollar funding surged, so did "safe-haven" demand. However, we expect the measures announced by the Fed to bolster liquidity will eventually reduce the upward pressure on the U.S. dollar.

## Euro: Tides turning

The euro has remained relatively resilient amidst the coronavirus outbreak, gaining against all G-10 currencies except for traditional "safe havens." The euro has fallen under notable pressure against the U.S. dollar. The lowering of U.S. interest rate expectations and the declining U.S. yield advantage could spur flows towards the euro, helping the currency to recover against the U.S. dollar.

## Canadian dollar: Dual pressure

The Canadian dollar experienced a dramatic decline against the U.S. dollar. The commodity-linked currency fell under the combined pressure of demand disruptions from the COVID-19 outbreak and crashing oil prices from the OPEC price war. We expect downside risks to weigh on the Canadian dollar, with some reprieve by year end, provided the virus outbreak is contained.

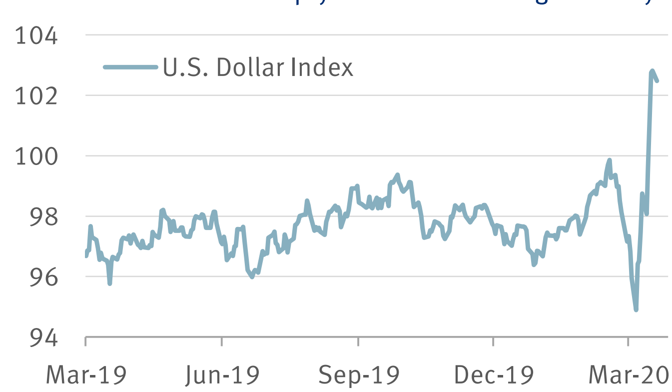
## British pound: Battered and bruised

The British pound's inherent vulnerability has been exposed in this extreme market volatility. Sterling has fallen sharply in line with the market selloff, in part due to markets' perception of the U.K. government's inadequate response, but also given the risk of an uncertain U.K./EU trading relationship, and the challenge of the country's large current account deficit. However, the sharp move lower appears overdone, in our view, and we expect a recovery from fresh lows.

## Japanese yen: Second best

After "safe-haven" demand sent the yen sharply higher in March, it appears to be losing its "haven" appeal as investors piled into the U.S. dollar on uncertainty and liquidity concerns. However, conditions remain supportive of long-term yen strength, in our view. Notably, falling U.S. short-end rates are likely to drive Japanese investors to hedge their foreign positions, leading to increased domestic demand for the yen.

### The U.S. dollar rose sharply as investors sought safety




As market volatility picked up mid-March, concerns about market liquidity and dollar funding under stress sent the U.S. dollar soaring.

Source - Bloomberg, RBC Wealth Management; data through 3/23/20

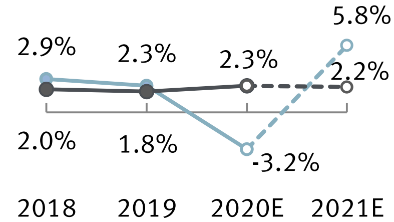

**Blaine Karbonik, CFA**
London, United Kingdom
blaine.karbonik@rbc.com

## Key forecasts

Real GDP growth    Inflation rate

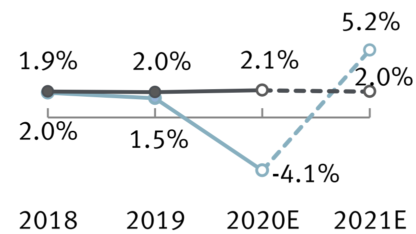
### United States – Massive policy moves

COVID-19 has taken a steep toll on the economy. The Fed instituted two surprise rate cuts, bringing the fed funds rate to 0%–0.25%, and has moved to provide liquidity for most types of corporate debt. Unemployment filings soared to almost 3.3 million. Consumer confidence has finally begun to weaken amid the market turmoil. Despite the record low interest rates, mortgage applications for both purchases and refinancings are down. Massive fiscal stimulus is on the way.



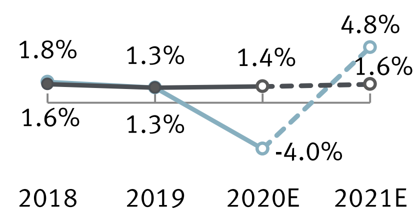

### Canada – Stimulus from all directions

The unemployment rate is already much higher than the last reported 5.6%. The BoC lowered its benchmark rate to 0.25% and announced QE plans to purchase commercial paper and government securities. The housing market, strong in the first two months of 2020, now looks to be in contraction. Unprecedented fiscal stimulus is arriving from both the federal and provincial governments.



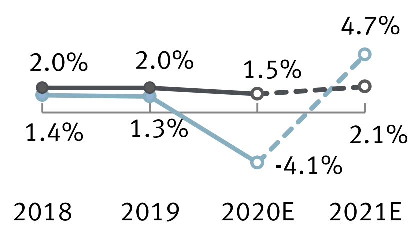

### Eurozone – Punishing lockdown

The already weak eurozone economy has been pummeled by the growing intensity of COVID-19-induced lockdowns. Fiscal stimulus commitments are expanding. Progress against the spread of the virus has been slow in arriving but may now be appearing in hard-hit Italy and Spain.



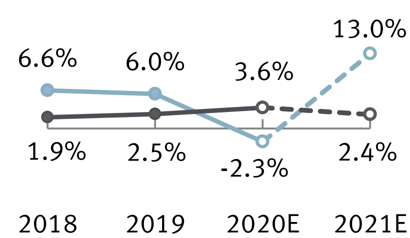

### United Kingdom – BoE lowers rates to record lows

The BoE cut interest rates to a record-low 0.1% and added £200 billion ($230 billion) to its asset purchase program to bring it to £645 billion. Slow to react, the government has imposed a restrictive shutdown. Trade policy uncertainty stemming from Brexit negotiating deadlines is exacerbating the fiscal response challenge.



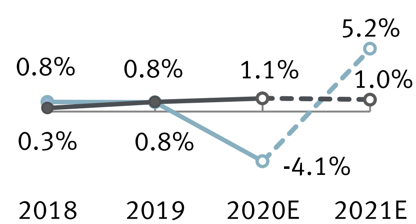

### China – PMIs improve

Both government and private surveys show China's manufacturing activity rebounded sharply from the deep February lows. However, new orders are weak, reflecting a very soft export picture. Stimulative policy moves continue to arrive as the economy restarts. Risks of a renewed infection pickup are elevated.




### Japan – BoJ buys ETFs

The BoJ, rather than cut interest rates further below zero, opted to purchase a record ¥201.6 billion of ETFs, marking the fourth time in March the central bank took efforts to calm markets amid growing COVID-19 concerns. As is the case everywhere, a big stimulus package has been rolled out.




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

# Market scorecard

| Index (local currency) | Level | 1 month | YTD | 12 month |
|---|---|---|---|---|
| S&P 500 | 2,602.93 | -12.5% | -20.0% | -8.8% |
| Dow Industrials (DJIA) | 22,139.16 | -13.7% | -23.2% | -15.5% |
| NASDAQ | 7,743.95 | -10.1% | -14.2% | -0.4% |
| Russell 2000 | 1,148.90 | -21.9% | -30.9% | -25.1% |
| S&P/TSX Comp | 13,342.95 | -17.7% | -21.6% | -16.9% |
| FTSE All-Share | 3,107.42 | -15.4% | -26.0% | -21.9% |
| STOXX Europe 600 | 320.06 | -14.8% | -23.0% | -15.6% |
| EURO STOXX 50 | 2,786.90 | -16.3% | -25.6% | -16.9% |
| Hang Seng | 23,603.48 | -9.7% | -16.3% | -18.8% |
| Shanghai Comp | 2,750.30 | -4.5% | -9.8% | -11.0% |
| Nikkei 225 | 18,917.01 | -10.5% | -20.0% | -10.8% |
| India Sensex | 29,468.49 | -23.1% | -28.6% | -23.8% |
| Singapore Straits Times | 2,481.23 | -17.6% | -23.0% | -22.8% |
| Brazil Ibovespa | 74,347.40 | -29.9% | -36.9% | -23.5% |
| Mexican Bolsa IPC | 34,978.04 | -16.4% | -20.6% | -20.2% |
| **Bond yields** | **3/31/20** | **2/28/20** | **3/29/19** | **12 mo. chg** |
| US 2-Yr Tsy | 0.204% | 0.913% | 2.260% | -2.06% |
| US 10-Yr Tsy | 0.654% | 1.149% | 2.405% | -1.75% |
| Canada 2-Yr | 0.423% | 1.155% | 1.549% | -1.13% |
| Canada 10-Yr | 0.688% | 1.132% | 1.617% | -0.93% |
| UK 2-Yr | 0.139% | 0.310% | 0.642% | -0.50% |
| UK 10-Yr | 0.356% | 0.442% | 1.000% | -0.64% |
| Germany 2-Yr | -0.689% | -0.601% | -0.602% | -0.09% |
| Germany 10-Yr | -0.471% | -0.185% | -0.070% | -0.40% |
| **Commodities (USD)** | **Price** | **1 month** | **YTD** | **12 month** |
| Gold (spot $/oz) | 1,598.21 | -0.5% | 3.9% | 22.0% |
| Silver (spot $/oz) | 14.04 | -16.1% | -21.7% | -7.6% |
| Copper ($/metric ton) | 6,486.50 | -12.1% | -19.7% | -23.9% |
| Uranium ($/lb) | 20.90 | -0.5% | -12.6% | -7.7% |
| Oil (WTI spot/bbl) | 20.59 | -54.2% | -66.5% | -65.9% |
| Oil (Brent spot/bbl) | 22.70 | -55.0% | -65.5% | -66.7% |
| Natural Gas ($/mmBtu) | 1.65 | -2.6% | -25.1% | -38.4% |
| Agriculture Index | 273.20 | -4.1% | -9.2% | 0.3% |
| **Currencies** | **Rate** | **1 month** | **YTD** | **12 month** |
| US Dollar Index | 99.4510 | 0.9% | 2.8% | 1.8% |
| CAD/USD | 0.7049 | -4.8% | -7.7% | -5.1% |
| USD/CAD | 1.4188 | 4.9% | 8.3% | 5.3% |
| EUR/USD | 1.0971 | 0.0% | -1.6% | -1.7% |
| GBP/USD | 1.2395 | -3.1% | -6.3% | -4.7% |
| AUD/USD | 0.6101 | -5.9% | -12.7% | -13.6% |
| USD/JPY | 107.7900 | -0.3% | -1.0% | -3.0% |
| EUR/JPY | 118.2600 | -0.3% | -2.6% | -4.6% |
| EUR/GBP | 0.8851 | 3.3% | 5.0% | 3.2% |
| EUR/CHF | 1.0597 | -0.4% | -2.3% | -5.0% |
| USD/SGD | 1.4240 | 2.1% | 5.7% | 4.9% |
| USD/CNY | 7.0825 | 1.3% | 1.7% | 5.5% |
| USD/MXN | 23.5084 | 20.5% | 25.1% | 21.8% |
| USD/BRL | 5.2004 | 16.4% | 29.2% | 32.8% |

Passage of $2 trillion CARES Act jumpstarted U.S. equity markets. The DJIA and S&P 500 came off their March lows of 18,591.93 and 2,220.50, respectively.

Investor flight to safety pushed global bond yields lower as coronavirus cases continue to escalate

Declining global demand and an ongoing production fight between Saudi Arabia and Russia have continued to pressure global oil prices lower.

The U.S. dollar rallied against all major currencies as global coronavirus cases mount.

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 0.70 means 1 Canadian dollar will buy 0.70 U.S. dollar. CAD/USD -5.1% return means the Canadian dollar has fallen 5.1% vs. the U.S. dollar during the past 12 months. USD/JPY 107.79 means 1 U.S. dollar will buy 107.79 yen. USD/JPY -3.0% return means the U.S. dollar has fallen 3.0% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 3/31/20.

# Research resources

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Jim Allworth – Co-chair; Investment Strategist, RBC Dominion Securities Inc.

Kelly Bogdanova – Co-chair; Portfolio Analyst, RBC Wealth Management Portfolio Advisory Group U.S., RBC Capital Markets, LLC

Frédérique Carrier – Co-chair; Managing Director & Head of Investment Strategies, RBC Europe Limited

Mark Bayko, CFA – Head, Portfolio Management, RBC Dominion Securities Inc.

Janet Engels – Head, Portfolio Advisory Group U.S., RBC Wealth Management, RBC Capital Markets, LLC

Thomas Garretson, CFA – Fixed Income Senior Portfolio Strategist, RBC Wealth Management Portfolio Advisory Group, RBC Capital Markets, LLC

Christopher Girdler, CFA – Fixed Income Portfolio Advisor, RBC Wealth Management Portfolio Advisory Group, RBC Dominion Securities Inc.

Patrick McAllister, CFA – Canadian Equities Portfolio Advisor, RBC Wealth Management Portfolio Advisory Group – Equities, RBC Dominion Securities Inc.

Alan Robinson – Portfolio Analyst, RBC Wealth Management Portfolio Advisory Group – U.S. Equities, RBC Capital Markets, LLC

Michael Schuette, CFA – Multi-Asset Portfolio Strategist, RBC Wealth Management Portfolio Advisory Group – U.S., RBC Capital Markets, LLC

Alastair Whitfield – Head of Fixed Income – British Isles, RBC Wealth Management, RBC Europe Limited

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## Additional Global Insight authors:

Jasmine Duan – Equity Analyst, RBC Investment Services (Asia) Limited

Blaine Karbonik, CFA – Associate, FX and Structured Products Specialist, RBC Europe Limited

Chun-Him Tam – Head of UHNW Solutions & Head of Fixed Income Asia, Royal Bank of Canada, Singapore Branch

Richard Tan, CFA – Canadian Equities Portfolio Advisor, RBC Wealth Management Portfolio Advisory Group – Equities, RBC Dominion Securities Inc.

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