Global Asset Management

For more on our current view and outlook, consult **The Global Investment Outlook**.

Investment outlook – Summer 2017

The economic uptick that took root in the summer of 2016 has continued to bloom and a synchronized global economic expansion is at hand, with leading indicators pointing to a faster-than-normal clip across much of the world. That said, the initial acceleration phase has arguably come to an end and, as a result, risk assets are still rising, but with less vim than at the turn of the year.

Delaying and diluting impact of Trump initiatives

The election of Donald Trump last autumn was a catalyst for financial markets, with sizeable implications for fiscal and foreign policy. However, expectations for major public policy changes under the new U.S. president have dimmed somewhat as the political landscape proves more difficult to navigate than initially anticipated. Accordingly, we now look for delayed policy action and diluted economic implications, with the net effect being slightly less negative for the long-run economy.

Growth signals appear to have peaked

We have slightly downgraded our 2017 developed-world growth forecast, but modestly upgraded the 2018 outlook. Most of this adjustment is the result of changes in the U.S. due to the delayed expectation of fiscal stimulus from 2017 to 2018. Canada and Japan have also enjoyed 2017 growth upgrades as they have been managing a particularly sprightly economic acceleration. In the end, we budget for a bit more economic growth over the next few years than was managed over the past several. However, we must not forget that there are still plenty of reasons why the sustainable growth rate is notably lower than it was a decade or two ago, and these are rooted in deteriorating demographics and a changing economic structure. Emerging-market economies collectively suffered through a multi-year period of decelerating economic growth, before righting themselves in recent years. We have upgraded our emerging-market growth forecast slightly for both 2017 and 2018, though these remain a bit below the consensus.

Downside risks remain but appear manageable

As is always the case, downside risks abound. The top three in our minds are the threat of protectionism, an aging business cycle and precarious international relations. Protectionism is a central risk given the rise of populism and the isolationist foundation that girds the movement. The aging business cycle also continues to merit careful tracking. Nothing whatsoever points to an imminent recession, but the risk is not trivial over the next few years. Finally, while past geopolitical risks have rarely had a large effect on markets, there is growing uncertainty around U.S. foreign policy and the nuclear capabilities that North Korea appears to be on the cusp of achieving, and these are not risks to be trifled with.

U.S. dollar bull market remains intact

Our currency outlook remains tilted toward appreciation of the U.S. dollar versus other major developed-market currencies. While this has been our stance for several years, our message is now more nuanced. We are more cautious than we have been due to the maturing U.S. dollar cycle and the possibility that dollar-negative factors are playing a larger role. There remain, however, valid reasons why this cycle could extend beyond the average, and they don't require heroic assumptions about dollar-friendly Trump policies. Growth differentials; a benign current account deficit, especially given the stage of the recovery; monetary policy divergences and only moderate overvaluation are among the reasons for staying bullish on the U.S. dollar.

Inflation to take a breather

Inflation has made a giant leap forward over the past year, exiting a multi-year period of deflation fears in favour of a somewhat more normal inflation environment. Having accelerated from rock-bottom to slightly low levels, inflation readings are now set to go mostly sideways over the next few quarters. This recognition has prompted us to slightly downgrade our 2017 inflation forecasts, leaving them a bit below the consensus. We persist in an above-consensus inflation outlook for 2018 and beyond as the business cycle ratchets tighter, helping to bring core inflation readings up to the standard of headline inflation.

Central banks leaning towards tighter monetary policy

In response to improving economies, central banks are leaning toward tighter monetary policy. The underlying motivation for this pivot is primarily that inflation readings are no longer quite so low and that economies appear to have achieved significant progress toward their full potential. The Fed, the world's bellwether central bank, is again setting the pace with a handful of rate increases already delivered, and more on offer. The Fed also plans to begin scaling back the size of its balance sheet toward the end of the year. Among other central banks, China has also been raising rates, though for more home-grown debt-related reasons. The Bank of Canada has stopped musing about rate cuts, the Bank of England seems content to allow its current round of quantitative easing to fade while the European Central Bank has already tapered its pace of bond buying slightly, though it is in no hurry to unwind its balance sheet.

Recent decline in bond yields reintroduces valuation risk

Global bond yields have drifted lower in the last quarter as enthusiasm about Trump's pro-growth policies has receded. The resulting drop in nominal bond yields has reintroduced the valuation risk that had mostly evaporated during the initial run-up after Trump's election. Although the trend so far this year has been towards lower bond yields, our models continue to suggest that the long-term direction of yields is higher. That said, a number of structural headwinds – aging populations, a limited capacity to take on debt, wealth inequality, globalization and a preference for safe assets – may limit the pace of the increase in bond yields. Our forecast for the U.S. 10-year yield is 2.50% a year out, and any deviation from our base case would likely be to the upside.

Stocks extend gains, earnings outlook brightens

The combination of a synchronized global expansion and an acceleration in corporate-profit growth has lifted global equities to new highs, driving valuations higher. While we recognize that stocks are nowhere near as cheap as they were when the bull market began eight years ago, equities in Canada, Europe and emerging markets all remain attractively priced. On a relative basis, the U.S. equity market has the fullest valuations, having recovered significantly from the depths of the financial crisis. As a result, improving valuations may no longer be a driving force for U.S. stocks and further gains will likely need to come from increasing corporate profits. Fortunately for equity investors, corporate profits have recovered from their two-year swoon and are now growing at their fastest pace of the post-crisis era. Therefore, it is not unreasonable to expect further gains in equities and, if profits rise as analysts expect, the total-return potential for stocks is still quite positive.

Trimming equity overweight

With modest growth in the economy and decent inflation, the outlook for sovereign fixed-income investments is unexciting. At current yields, prospective returns for bonds are extremely low or even negative. As a result, we remain underweight fixed income in our asset mix. While prospective long-term returns for equities are much better than for bonds, key signals have prompted us to modify our degree of enthusiasm for stocks. Having harvested the stock market's outsized gains that resulted from the recent economic acceleration, we have begun to scale back our risk-taking by reducing our allocation to equities. This is further motivated by the ongoing maturation of the business cycle, by equity valuations that are becoming less compelling and concern that complacency is beginning to seep into markets. The tweak leaves our equity overweight intact, however. For a balanced, global investor, we currently recommend an asset mix of 59% equities (strategic neutral position: 55%) and 38% fixed income (strategic neutral position: 43%), with the balance in cash.

This report has been provided by RBC Global Asset Management (RBC GAM) for informational purposes only and may not be reproduced, distributed or published without the written consent of RBC Global Asset Management Inc. (RBC GAM Inc.). In Canada, this report is provided by RBC GAM Inc. (including Phillips, Hager & North Investment Management).

RBC GAM is the asset management division of Royal Bank of Canada (RBC) which includes RBC GAM Inc., RBC Global Asset Management (U.S.) Inc., RBC Global Asset Management (UK) Limited, the asset management division of RBC Investment Management (Asia) Limited, and BlueBay Asset Management LLP, which are separate, but affiliated subsidiaries of RBC.

Any investment and economic outlook information contained in this report has been compiled by RBC GAM from various sources. Information obtained from third parties is believed to be reliable, but no representation or warranty, express or implied, is made by RBC GAM, its affiliates or any other person as to its accuracy, completeness or correctness. RBC GAM and its affiliates assume no responsibility for any errors or omissions.

All opinions contained within constitute our judgement as of June 13, 2017, are subject to change without notice, and are provided in good faith without legal responsibility. This report is not intended to provide legal, accounting, tax, investment, financial or other advice and such information should not be relied upon for providing such advice. The investment process as described in this report may change over time. The characteristics set forth in this report are intended as a general illustration of some of the criteria considered in selecting securities for client portfolios. Not all investments in a client portfolio will meet such criteria. RBC GAM takes reasonable steps to provide up-to-date, accurate and reliable information, and believes the information to be so when printed. RBC GAM reserves the right at any time and without notice to change, amend or cease publication of the information.

This report may contain forward-looking statements. The words “may”, “could”, “should”, “would”, “suspect”, “outlook”, “believe”, “plan”, “anticipate”, “estimate”, “expect”, “intend”, “forecast”, “objective” and similar expressions are intended to identify forward-looking statements. Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risk and uncertainties, about the general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved.

® / ™ Trademark(s) of Royal Bank of Canada. Used under licence.
© RBC Global Asset Management Inc. 2017

Global Asset Management

32467 (06/2017)
015GAM163_32467 (06-2017)_IO_EN_V1_2 06/20/2017