GLOBAL
Insight

Perspectives from the Global Portfolio Advisory Committee

October 2024

The price of success is steep, but not too steep

The Fed has finally aggressively lowered interest rates. While a steeper yield curve reflects the market's optimism that rate cuts will shore up the economic outlook, further steepness could be a sign the Fed will cut rates deeply, likely due to a recession.

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Produced: Oct. 2, 2024, 11:59 ET; Disseminated: Oct. 2, 2024, 14:00 ET

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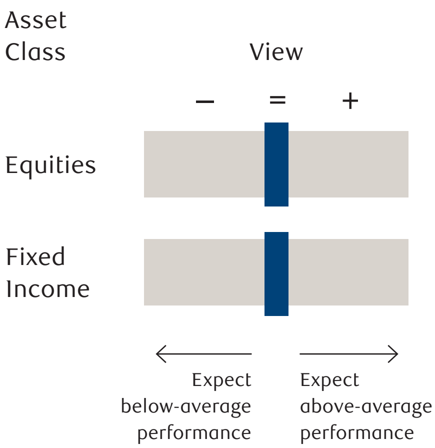

(+/=/–) represents the Global Portfolio Advisory Committee's (GPAC) view over a 12-month investment time horizon.

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

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

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

Source - RBC Wealth Management

Equities

- As more central banks have shifted from raising to cutting interest rates—most notably the U.S. Federal Reserve—major equity indexes rallied to new all-time highs including the S&P 500, Canada's TSX, and STOXX Europe 600, along with global indexes.
- Optimism about a U.S. economic soft landing has risen among market participants and contributed to the rallies. Even though recession risks still remain visible, RBC Global Asset Management Inc. Chief Economist Eric Lascelles moved his recession probability for the next 12 months back down to 30% from 40%. S&P 500 profits seem on course to grow by double-digits this year and advance further next year so long as the economy remains resilient.
- China's recent multi-faceted stimulus package added another layer of global growth optimism, and boosted not only emerging market equities, but stocks in developed markets with revenue exposure to the country.
- We maintain a Market Weight stance on U.S. and global equities and continue to emphasize high-quality dividend-paying shares whose valuations are supported by earnings growth prospects.

Fixed income

- Global bond yields have fallen to the lowest levels of the year as the average yield on the Bloomberg Global Aggregate Bond Index declined to around 3.3% in September after reaching a 2024 high of 4.1% in April. A number of central banks have already taken steps to loosen monetary policy via rate cuts, with the U.S. Federal Reserve following suit with a larger-than-anticipated 50 basis points rate cut at its September policy meeting. We continue to anticipate further rate cuts from all major central banks this year.
- Global inflationary pressures continue to improve after a brief uptick to start the year allowing central banks to begin monetary policy easing cycles, but their focus is increasingly shifting to economic growth and labor market concerns from inflation. We broadly continue to recommend that fixed income investors look to extend duration into a global easing cycle, but after the recent sharp drop in yields in anticipation of such easing, some patience may be called for.
- We reiterate our Market Weight stance on U.S. fixed income with yields remaining above multi-decade averages. Globally, we favor sovereign bonds over corporate bonds as we think valuations in the latter remain relatively rich compared to what are still elevated economic risks ahead.

MONTHLY
Focus

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The price of success is steep, but not too steep

The Fed has finally moved aggressively to dial back interest rates, undoing a yield curve inversion that has been in place since February 2022 in the process. While a steeper yield curve reflects the market's optimism that rate cuts will shore up the economic outlook, we believe further steepness could be taken as a sign the Fed will cut rates deeply, likely in response to a recession.

The Fed finally joined a handful of global central banks in dialing back interest rates in response to the significant progress made on the global inflationary wave which peaked way back in 2022.

But to achieve that, the Fed had raised interest rates to the highest levels in the U.S. since 2007 by the middle of 2023, and left them there for one of the longest stretches on record, perhaps raising the prospect of an economic slowdown as a result. But the early read based on the market response is that the Fed's proactive, and supersized, 50 basis point (bps) cut in September—along with indications that more is to be done—should shore up the economic outlook even as concerns linger.

To wit, RBC Global Asset Management Inc. Chief Economist Eric Lascelles also views the Fed's proactive move favorably, downgrading the chances of a recession within the next 12 months to 30 percent, from 40 percent previously. Supporting that view he notes that:

- The Fed cut its policy rate by 50 bps. This simultaneously supports the economy and signals that the Fed could continue to move quickly if the economy were to stumble.
- Economic data has improved over the past six weeks, with the ISM Services Purchasing Managers' Index rebounding back above 50 (indicating expansionary activity), the unemployment rate edging lower, jobless claims falling steadily, retail sales reporting an unexpectedly chipper outcome, and Q3 GDP growth tracking a strong 3.1 percent annualized, according to the Atlanta Fed's GDPNow model.
- Little stress appears visible in credit markets. Credit spreads are narrow, mortgage rates are falling, and bank lending standards are easing.
- Lower oil prices provide further support for economic growth, and also reduce the risk of inflation reigniting.

That said, downside risks for the U.S. economy—and particularly for the labor market—have not completely dissipated, and we do expect further supersized rate cuts from the Fed over the near term.

More now, less later

With a 50 bps rate cut out of the gate, we think the Fed may have learned the lessons of the 2022 rate hike cycle. In March 2022, policymakers kicked

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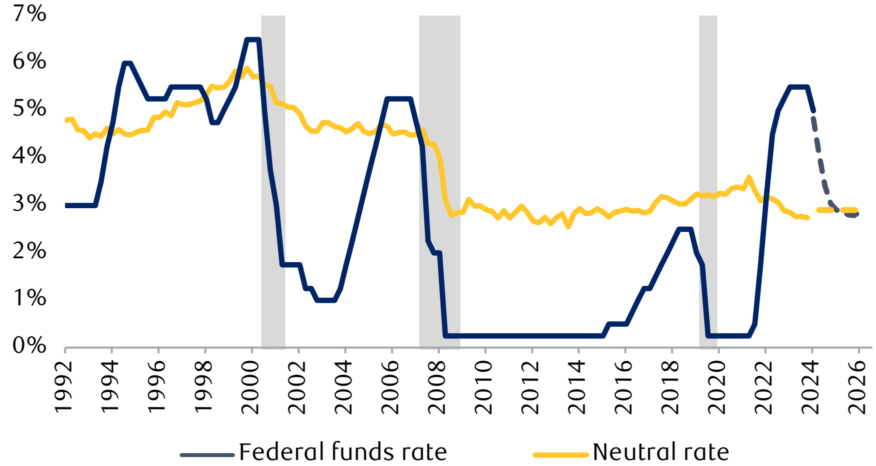
things off with a standard hike of 25 bps, but immediately had to shift gears with a run of jumbo hikes of 50 bps, 75 bps, 75 bps, 75 bps, 75 bps, and 50 bps to play catch up to inflation before a series of 25 bps hikes closed out the policy tightening cycle in July 2023.

So that risk of getting off to a slow start, and potentially falling behind a cooling economy, perhaps factored into the Fed's thinking, and is why we believe there will be at least a handful of more large cuts. As the chart below shows, markets are pricing a swift return toward more neutral levels—that is to say, levels that are neither restrictive nor stimulative for economic growth and inflation—which the Fed now judges to be somewhere around three percent, still a historically elevated level.

Markets are pricing a swift return to "neutral" interest rates



Dashed lines indicate the market-implied path of the federal funds rate and the Federal Reserve's estimate of the neutral interest rate (a policy rate above neutral is considered restrictive of economic growth; a rate below is considered supportive). Shaded areas indicate U.S. recessions.

Source - RBC Wealth Management, Federal Reserve Bank of New York, Bloomberg; data as of 9/24/24

With all eyes on the labor market, consumer sentiment toward it is still deteriorating and supports our view that the Fed will likely deliver at least one more 50 bps reduction this year. As the next chart shows, 18 percent of consumers surveyed reported that jobs were "hard to get" in the Conference Board's monthly survey for September, which is up from just 11 percent at the start of the year. Over the past 30 years, this survey has had a 90 percent correlation with the official unemployment rate and suggests that further rises in unemployment could be in the offing.

And the bar to more rate cuts based on labor market conditions could be quite low. At the September policy meeting, the Fed's 100 bps of projected rate cuts this year was predicated on the unemployment rate rising only moderately further to 4.4 percent, from 4.2 percent. Should it rise faster, the Fed would likely also cut rates faster still. With two more payrolls reports scheduled to be released before the next meeting on Nov. 6–7, that data will be key in determining what the Fed does next.

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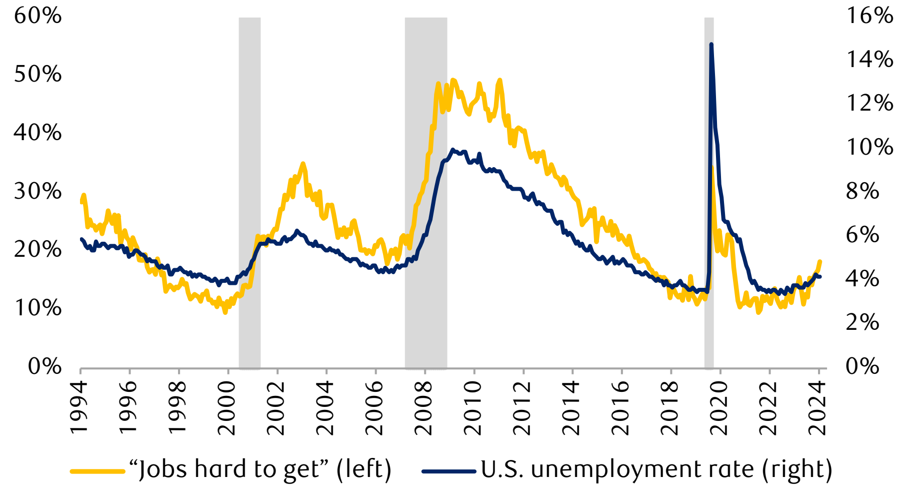
Consumers continue to flag a weakening U.S. labor market



"Jobs hard to get" represents the percentage of respondents to the Conference Board's monthly Consumer Confidence Survey expressing that view. Shaded areas indicate U.S. recessions.

Source - RBC Wealth Management, U.S. Bureau of Labor Statistics, Conference Board; data through September 2024

The main point is that we think the Fed needs to move quickly to return policy rates closer to "neutral" levels. The time to fine-tune and calibrate monetary policy more precisely around whatever level of interest rates that might be "neutral" for the economy will come later, in our view.

The price of success is steep, but not too steep

The yield curve is probably one of the most important, and reliable, market signals there is with respect to the economic outlook. Intuitively, it's quite simple. The Fed controls short-term rates, while longer-term rates are largely influenced by market participants and generally reflect the market's expectations for economic growth and inflation.

When the curve is inverted, as it had been up until recently, it's the market's signal that policy rates are likely restricting economic activity and inflation. When the opposite is true, the Fed's policy rate is judged to be stimulative for growth and inflation.

For investors still wary about recessions risks, this may be the metric to watch. There's no hard and fast rule—wouldn't that be nice—but historically it appears to be the case that once the yield curve has re-steepened to >100 bps it has been closely followed by a recession. Intuitively, that gap grows because the 2-year Treasury yield is dropping sharply, and faster than long-term yields, on the market's expectations that the Fed will be delivering deep rate cuts in response to an economic contraction.

But can the Fed find the middle ground? There's really only one episode of the yield curve simply staying flat after a series of Fed rate cuts that were then held steady for a period of time, which came in the mid-to-late 1990s. Current consensus rate forecasts do indeed have the yield curve holding this "Goldilocks range"—a relatively steep yield curve that should signal modest support for the economy without reigniting inflation risks, but not so steep that the Fed is likely cutting rates because of a recession.

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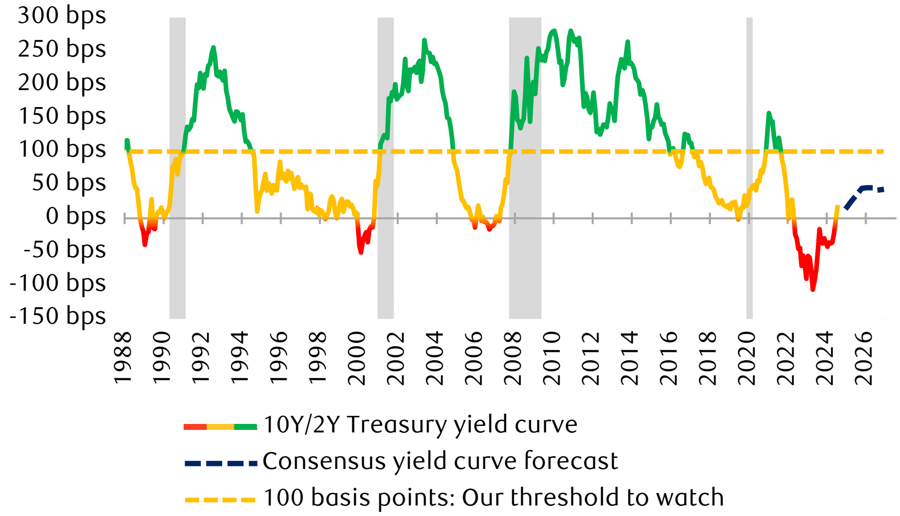
The end of an inversion

The 10Y/2Y Treasury yield curve's return to positive territory after a period of deep inversion may have significant economic ramifications



Shaded areas indicate U.S. recessions.

Source - RBC Wealth Management, Bloomberg

Fixed income portfolio strategy

Policymakers may have just started cutting rates, but in the eyes of markets, it's as though they've already finished.

As is usually the case, markets price the future. And as it stands, markets are fully priced for 200 bps of further rate cuts through 2025, which is already being largely reflected in bond prices and yields.

As the chart on the next page shows, most fixed income sectors have been on a strong run over the past year, gaining an even bigger head of steam back in April when the 10-year Treasury yield hit 4.7 percent, which has since faded as low as 3.6 percent. As yields fall, bond prices rise, and on top of coupons earned, this combination has fueled strong total return performance of late.

We have spent the past few months urging investors to exit cash and/or short-maturity bonds in favor of locking in yields via longer maturities ahead of Fed rate cuts.

The Bloomberg U.S. Aggregate Bond Index is up eight percent over the past year—or what is typically a strong year for the S&P 500 Index. High-yield corporate bonds are in the midst of one of their best runs on record—partly reflecting investor optimism that the Fed, at least for now, has staved off recession risks.

Unfortunately for fixed income investors, a lot of performance has already been squeezed out of bond markets, and to extract significantly more juice from them at the current juncture would likely require markets repricing greater risks of a hard landing for the U.S. economy—something that is not currently our view.

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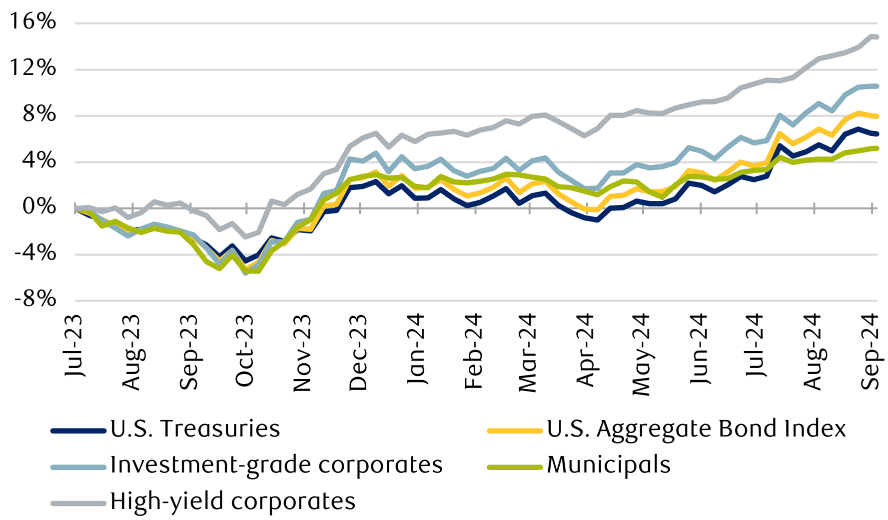
So, the playbook may not be much more exciting than "buying the dips" in bonds, or increases in yields, gradually extending duration in the process and keeping fixed income sector allocations relatively neutral, as there are few clearly attractive options available at the moment, in our view.

As credit markets remain historically rich, we would still favor quality. Even in a best-case scenario for the economy, we think sectors like investment-grade bonds will likely only keep pace with U.S. Treasury bonds in terms of performance, so we would likely favor the downside protection—and capital preservation—that Treasuries could provide for portfolios in the event of a recession.

Bonds have been on a strong run for the past 12 months

Market performance since the previous Fed rate hike (July 2023)



Source - RBC Wealth Management, Bloomberg; Treasuries represented by the Bloomberg U.S. Treasury Index, corporates by the Bloomberg U.S. Corporate Bond Index and U.S. High Yield Corporate Bond Index, municipals by the Bloomberg Municipal Bond Index; data through 9/23/24

Consumer rate implications

Finally, what do the Fed's rate cuts mean as a practical matter? As noted, Treasury yields have been dropping for months on investor anticipation of Fed rate cuts, so as we see it, much of what the Fed does from here is simply following through. Put differently, market rates have already priced in the bulk of future rate cuts, and consumer rates should gradually reflect that in the months ahead.

For example, 30-year mortgage rates are essentially priced off the 10-year Treasury yield. On April 25, both the 10-year Treasury yield and the average 30-year mortgage rate hit a 2024 high of 4.7 percent and 7.6 percent, respectively. Since then, each has declined by roughly 90 bps to 3.8 percent and 6.7 percent, respectively.

So, where might mortgage rates head from here? There are two things to consider: the 10-year Treasury yield itself, and the gap between it and 30-year mortgage rates, which currently stands at roughly 300 bps.

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The Bloomberg consensus analyst survey for September now has the 10-year yield falling to 3.7 percent by early next year, and toward 3.6 percent by the end of 2025. Should spreads stay flat, that would suggest to us that mortgage rates might have already reached their near-term lows.

But what about spreads? At 300 bps over the 10-year Treasury yield, mortgage rates are historically expensive. Prior to the pandemic, that spread was closer to 150 bps–200 bps. The reasons are too numerous to cover here, but in short, we do see some scope for mortgage spreads to compress, particularly if the Fed ceases shrinking its balance sheet, as we see as likely later in 2025.

If lower yields and narrower mortgage spreads come together, we think the next stop for mortgage rates could be 6.0 percent, fading toward 5.0 percent later on. But lower rates than that might only come about in a recessionary episode.

Not quite there yet

The Fed hopes that a series of interest rate cuts will be enough to stave off a recession and support a continuation of the economic expansion. But it must be said, that's always how central bankers hope that easing cycles play out—it's just rarely the case that they do.

While we are encouraged by the Fed's proactiveness and support the view that a soft landing remains on the table, we must be cognizant of the fact that after an aggressive rate hike cycle, and one which saw about 14 months between the last hike and the first cut, the balance of risks for the economy is naturally going to be tilted to the downside for some time yet.

GLOBAL

Equity

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Sapping support?

The equity market advance from the depressed lows of 2022 has now been running for 24 months. The only pullback of note was the three-month, 10% correction in the spring of 2023. Since that point, there has only been one instance with a monthly close lower for the S&P 500. The same, more or less, can be said for every stock market in the developed economies.

Alas, there is no monthly "count" that tells us when the next correction is "due." The gap between one painful occurrence and the next has varied widely between a couple of months and several years. This current advance could have further to run, in our view. However, two measures—sentiment and valuation—are providing much less support than they were two years ago.

Investors complacent about a richly valued market

At the market lows in October 2022 several measures of investor sentiment were extremely downbeat. Over the intervening 24 months investor attitudes have gradually bubbled higher: bullishness is now consistently posting well-above-average readings and bearishness well below. While we think sentiment can't yet be rated as "frothy" or "irrationally exuberant," "complacency" is very much in evidence.

Valuation tells a similar story. At the October 2022 low the S&P 500 was trading at a very reasonable 16x that year's earnings—fractionally above its long-term average. Today it's at a rich 23.2x this year's consensus earnings estimate of $247 (up 11.2% y/y) and 20.5x next year's projected $280 (up 13.3% y/y). "Priced for perfection" probably overstates the case, but "priced for a continuation of above-average earnings growth" looks like the correct assessment to us.

Equity views

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

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

Price-to-earnings (P/E) ratios moving up from depressed levels is a welcome signal to us that the outlook for the economy and corporate profit growth is moving back to normal. But as we see it, P/Es moving up from already extended heights smacks of investors coming to believe that higher-than-average earnings growth is here to stay—rarely a sustainable expectation.

That said, recent annual revisions of past data have revealed that corporate revenues and profits for the past year, as well as consumer incomes and savings, were higher than first reported. Those revisions for the overall U.S. economy won't change the earnings already reported for the S&P 500 but are likely to make analysts more comfortable with their estimates for this year and next. (The revisions have not pushed any of our Recession Scorecard indicators back into more favorable readings.) It is unclear to us whether this better-than-reported economic data will make the U.S. Federal Reserve any less inclined to cut rates at upcoming policy meetings.

Consumers are downbeat

Our focus is on the U.S. consumer (approximately 70% of GDP). Not only have households' assessments of current conditions sagged sharply from the beginning of the year, but a

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growing percentage of respondents in the Conference Board's monthly Consumer Confidence Survey for September are reporting that "jobs are hard to get," a statistic that correlates well with the unemployment rate. Some consumer behavior is reflecting these concerns.

The Mortgage Bankers Association reports that mortgage applications in the U.S. have risen sharply since the spring. However, those applications relating to the purchase of a home have been comparatively subdued, while the number of applicants looking to refinance an existing mortgage has surged dramatically (up 20% in the most recent week) and accounts for most of the action. Since rates have not fallen enough to suddenly make refinancing for financial advantage very enticing, we look for another rationale.

It would make sense to use lower-cost mortgage debt to pay down high-cost consumer debt: credit card rates are now at 23%, up from 9% two years ago, while car loan rates are at 9%, up from 4%. But so far, we see little evidence this is happening. Credit card balances and auto loans continue to rise as do loan delinquencies.

So, mortgage refinancing looks to be headed toward supporting existing spending levels rather than paying down debt, a worrying trend but not yet a dire one.

We expect U.S. GDP growth to slow through 2025—perhaps by enough to induce a recession, perhaps not. Central bank rate cutting almost everywhere is welcome, especially from the Fed, but monetary policy acts with a lag so these preliminary rate cuts are unlikely to show up in improved economic activity before midsummer of next year. Nor should one count on rate cutting by itself to head off a recession: the Fed had already begun cutting the funds rate before the start of eight of the last 10 recessions.

Proceed with caution

Corrections can arrive seemingly "out of the blue." It would be tempting to predict one will arrive soon, given today's rich P/E multiples together with the prevalence of investor optimism or, at least, complacency. However, we will resist that temptation, acknowledging that the odds of being wrong are high either way.

That said, we will again point out that one very reliable precursor of an impending bear market (as opposed to a correction) is so far nowhere in sight—namely, a trend breakdown in market breadth. Both the S&P 500 advance-decline line and the "equal-weighted" version of the S&P 500 have been racing ahead making a succession of new highs, with the more closely followed S&P 500 capitalisation-weighted index quickly following suit.

Things proceed differently when a bear market is in the offing. The advance-decline line turns lower as the majority of stocks fall into downtrends, even as an ever-smaller number of heavily weighted, high-performing stocks push the index on to a final cycle high. No such divergence is apparent today.

As long as market breadth remains "in gear" with the broad averages, we are inclined to give stocks the benefit of the doubt.

However, were a new market up-leg to emerge, wherein breadth measures failed to participate and moved into a downtrend, a deeper, broader retrenchment for equity markets might be in the works. All the more reason why we believe a cautious, watchful approach is called for.

Regional equity perspectives

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United States

- After a couple of pullbacks in Q3, the S&P 500 bounced back as it became clearer that the Federal Reserve would cut interest rates for the first time since spring 2020. It reached a new all-time high on September 19, the day after the Fed made its first move by lowering rates 50 basis points.

- Three factors will likely shape the market's trajectory the most in the coming months: (1) corporate profit results for Q3 and the trend in Q4 2024 and 2025 consensus earnings estimates; (2) economic data, specifically those that signal whether a soft landing or recession is most likely, and; (3) how the Fed responds to economic data in terms of the timing and magnitude of further rate cuts.

- Heading into the Q3 earnings reporting season, which kicks off soon, the S&P 500 consensus forecast for the quarter has held steady at $61 per share in the past month, according to Refinitiv I/B/E/S. Earnings estimates usually decline ahead of the results season.

- The market hasn't responded much if at all to the presidential election campaign thus far this year—despite the unusual and unprecedented events that have occurred and the big policy differences between the two main candidates. So far, the S&P 500 has significantly outperformed the average 7.5% gain in presidential election years going back to 1928, as the chart shows. This has been mainly due to optimism about the economy and artificial intelligence innovation. It would not be surprising to see some volatility before or after the election.

- Regardless of the election results, we remain convinced that other factors will play greater roles in shaping the market's mid- and long-term direction such as the natural ebb and flow of the business cycle, the Fed's monetary policies, and industry innovation.

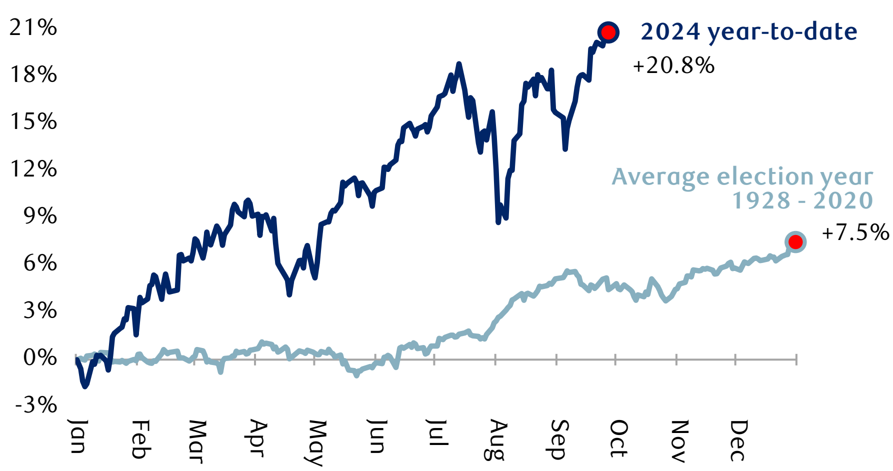
- We continue to recommend Market Weight exposure to U.S. equities—a constructive allocation. We don't see tangible signs that the bull market could come to an end just yet, but are cognizant that recession risks still linger.

Canada

- Canada's economy grew by 2.1% in Q2 2024, though it was still insufficient to slow the trend of negative growth on a per-capita basis. Household spending has slowed, with consumers allocating a greater proportion of their income to debt-servicing costs. The conditions

Atypical market performance this year

S&P 500 returns in presidential election years



Source - RBC Wealth Management, Bloomberg; price data in presidential election years, not including dividends; 2024 data through 9/30/24

REGIONAL EQUITY PERSPECTIVES

remain in place for continued Bank of Canada rate cuts, which would help cushion households from the full brunt of higher rates and, in RBC Economics' view, should support modestly positive economic growth through 2025. However, we remain alert to downside risks and acknowledge the pressures already facing lower-income consumers. We continue to advocate reviewing equity portfolios through that lens, espousing a quality bias and eschewing exposure to discretionary spending.

- Banks delivered largely better-than-expected fiscal Q3 2024 results, with one notable exception that saw credit losses exceed expectations. Valuations are what we would deem fair in the context of a potential economic soft landing and the likely peak in credit losses that lies ahead. We are looking for more evidence of the latter before turning more positive on the group.

- We continue to see opportunities in Industrials with several companies presenting reasonable valuations in the context of expected earnings growth and franchise quality.

- In resource sectors, precious metal miners have outperformed amid record gold prices. Though difficult to forecast, central bank demand to diversify their reserves remains a powerful theme for gold.

- We continue to like the prospects for cash returns to shareholders among oil producers. We see oil prices as potentially rangebound with geopolitical risks providing a floor and excess capacity providing a ceiling to prices. Nevertheless, the US$70–US$80 per barrel range provides sufficient cash generation for attractive returns, in our view.

- Amongst the weakest areas of the market has been Telecommunications Services. The competitive intensity that commenced early last year has continued thus far in 2024 as the incumbents fight for market share. Elevated competitive intensity, a slowing growth outlook, high interest rates, and elevated balance sheet leverage leaves us apathetic on the sector.

United Kingdom

- The UK economy, which had performed solidly in H1 2024, seems to be losing momentum. July GDP was flat month over month. Yet, with September Purchasing Managers' Indexes still firmly in expansion territory, the UK economy may well be able to eke out the 1.1% growth in 2024 RBC Capital Markets expects.

- With inflation trending lower but still relatively firm, monetary policy will likely remain tight this year. In August, core inflation, which excludes oil and food prices, reached 3.6% and services inflation, a key metric for the Bank of England, still hovers above 5.5%. RBC Capital Markets expects the bank rate will reach 4.75% at the end of 2024, down from the current 5.0%.

- The new Labour government's opening shot was a major overhaul of the nation's finances. The chancellor highlighted an overspend of just under 1% of GDP left by predecessors. The upcoming budget, to be announced on October 30, is very likely to include tax increases which could affect economic growth prospects.

- Despite the noisy domestic backdrop, UK equities have been the best-performing major developed market in the past six months in U.S. dollar terms, with the FTSE All-Share Index delivering an approximate 12% total return. The UK's more defensive sector composition has been a key support, with Health Care, Consumer Staples, and Utilities outperforming, which has helped UK equities of late relative to other markets. If defensive market leadership persists, there may be further legs to the UK's outperformance run.

- UK valuations remain close to record inexpensive levels. On a sector-neutral basis (i.e., adjusting for sector biases), the UK is trading much below its relative long-term median price-to-earnings ratio versus global developed markets.

REGIONAL EQUITY PERSPECTIVES

- We believe quality UK large caps, trading at a valuation discount to peers listed in other markets, remain attractive long-term opportunities for global investors. We also see selective opportunities in domestically focused UK stocks, particularly exposed to UK consumer spending which, in our view, will benefit from interest rate cuts over the next 12 months.

Continental Europe

- In Europe, growth has fallen short of market expectations, and September economic indicators now suggest meagre 0.1% q/q GDP growth at best in Q3. Despite anemic economic growth, labour markets remain remarkably healthy with unemployment of 6.4%, a 25-year low. This may complicate the outlook for rate cuts if labour market tightness leads to upward pressure on wages, underpinning inflation. Nevertheless, if growth continues to disappoint, the European Central Bank may opt to step up its easing pace as inflation is finally approaching the 2% policy target.

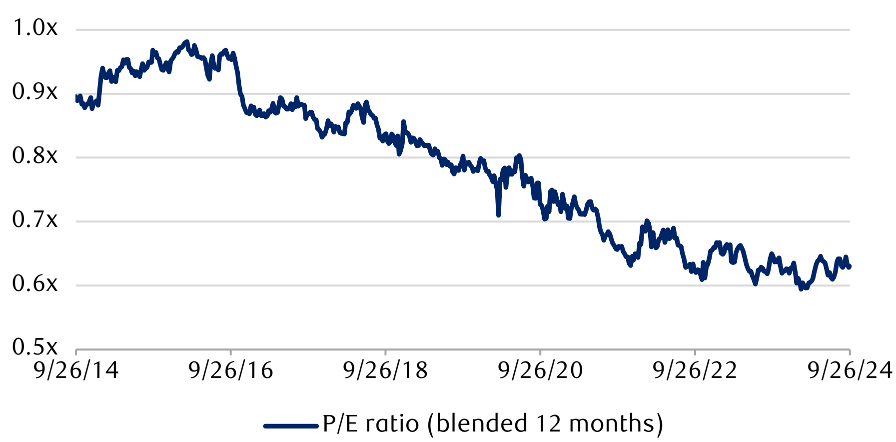
- The European equity market is not representative of the European economy, and has markedly evolved over the past decade. Today, a greater proportion of European companies' revenues are derived from outside the region as opposed to domestically. We believe both these structural changes and its cyclical nature make the European equity market primed for active stock picking rather than a passive approach.

- Given the region's domestic challenges, we have long advocated focusing on Europe's world-leading companies that benefit from and drive structural global trends. Some examples are companies focused on niche areas key to the future of the global economy or those at the forefront of providing innovative solutions to sustainability challenges.

- Europe is home to many companies that provide the equipment and solutions needed for what we believe will be a multi-year capex super-cycle associated with the significant investment related to structural trends such as electrification, reshoring, and digital transformation including Artificial Intelligence. We find attractive long-term opportunities in niches such as semiconductor manufacturing equipment, electrical and mechanical engineering, and industrial gases. Moreover, China-exposed cyclicals, that have significantly underperformed of late, would stand to benefit should the recently announced monetary stimulus in China be followed up with additional fiscal support.

UK equity valuations remain depressed

FTSE All-Share Index price-to-earnings ratio relative to that of the MSCI World Index



Source - RBC Wealth Management, Bloomberg

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■ Elsewhere, we continue to believe that there are several attractive investment opportunities within Europe's Healthcare sector, as well as selectively within consumer areas and Financials.

Asia Pacific

■ Chinese policymakers surprised the market with stronger-than-expected stimulus measures in late September. The People's Bank of China announced a coordinated package of policies aimed at lower interest rates and increasing liquidity in the stock market. The September Politburo meeting, a gathering of the Party's top decisionmakers, conveyed a clear message: more aggressive fiscal and monetary policies are on the way to stabilize the property market and support the equity market.

■ While many fiscal policies have yet to be confirmed, we think the above measures signal a significant shift in policy direction. The Politburo meets monthly. But, historically, policymakers have concentrated on discussing economic conditions and policies primarily during their April, July, (occasionally October), and December meetings. We think the announcement of major stimulus in September indicates a sense of urgency and determination to support the economy. Additionally, with the Federal Reserve cutting its fed funds rate by 50 basis points, we think there is further room for China to ease its policies.

■ We have turned more positive on Chinese equities, as we believe these measures have mitigated systematic risks in the economy, particularly in the property market. Improved liquidity should support a valuation recovery of Chinese equities. For a more sustainable market rally, we think more fiscal policies need to follow, which we expect to be gradually announced later this year and/or early next year. We think Internet equities and the Consumer Discretionary sector, whose earnings are highly correlated with the economic cycle, will benefit from this round of stimulus.

■ The Bank of Japan (BoJ) held its benchmark policy rate unchanged in September as expected by market participants. We reiterate our view that any immediate rate hike remains unlikely following the sharp market correction post the first interest rate hike in July and the impending change in Japan's Prime Minister in early October. The latest commentary by BoJ Governor Kazuo Ueda on the need for more time to confirm the state of the economy further reduces the likelihood of a rate hike at the October meeting, in our view. Most economists are now expecting the BoJ to resume its rate hike cycle in December. RBC Capital Markets expects the yen to weaken slightly against the U.S. dollar from the current level to end the year at 147.

■ Longer term, we reaffirm our positive views on Japan equities as a sustainable 2% inflation target seems in sight; renewed investment from friendshoring and onshoring should underpin economic activity; return-on-equity and shareholder returns are improving thanks to corporate governance reforms; domestic demand should recover thanks to high savings and further wage hikes; inbound tourism remains strong; and we expect elevated domestic retail inflows into the stock market following the revamped Nippon Individual Savings Account scheme.

Regional fixed income perspectives

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Global bond markets are likely to continue to serve as portfolio ballast at a time of heightened global uncertainty, and particularly so amid ongoing central bank policy easing cycles. However, global bond market rallies on the back of falling yields are already approaching historically strong runs, which could set the stage for a pause and may be reason to be patient. For a full account of our thinking, see this month's focus article, "The price of success is steep, but not too steep."

Fixed income views

Region	Gov't bonds	Corp. credit	Duration
United States	+	–	7–10
Canada	+	=	3–7
Continental Europe	+	=	3–7
United Kingdom	+	=	3–7

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

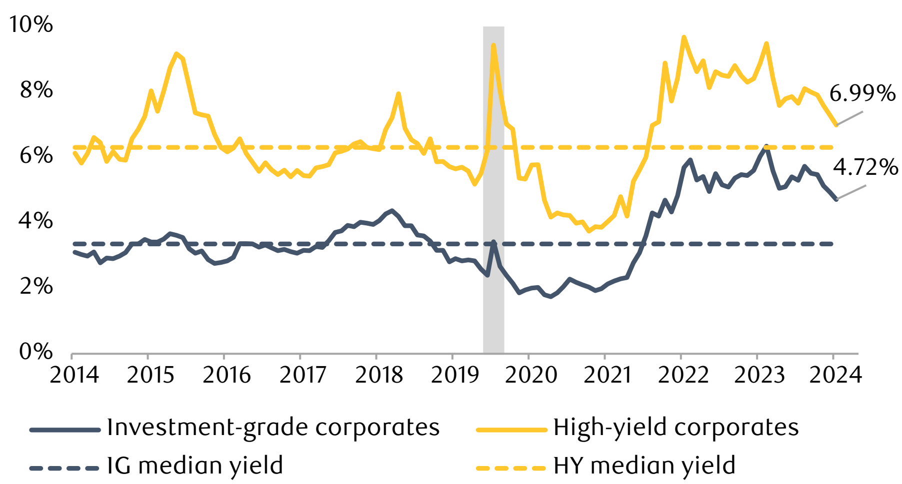
United States

- The Federal Reserve cut its overnight policy rate by 50 basis points in September, bringing the target range down to 4.75%–5.00%. Bonds have rallied in anticipation of the Fed's rate cut cycle with the Bloomberg U.S. Aggregate Bond Index returning nearly 6% over the past six months, one of its best runs of the past 20 years. Our base case is that the Fed cuts rates by a further 75 basis points this year to a 4.00%–4.25%, range, which is largely already priced into markets. We expect bonds to continue to perform well, but after the recent rally we see more muted returns for the balance of the year.

- Fed rate cut expectations, labor market concerns, and geopolitics all dragged longer-term Treasury yields lower through September with the benchmark 10-year Treasury yield falling as low as 3.62%, having traded as high as 4.70% this year. As a result, we turned back to a neutral duration outlook though we still believe the longer-term trend is lower. Its yield could bounce back toward 4.00% over the near term, but we would likely view that level or above as another entry point into longer-dated bonds.

- The yield on high-yielding corporate bonds aren't so high anymore. The average yield on the Bloomberg High Yield Corporate Bond Index dipped below 7.0% for the first time since April 2022 on a combination of falling Treasury yields and tightening credit spreads—or the yield compensation for implied credit risks—to Treasuries.

U.S. corporate bond yields quickly falling toward more historically normal levels



Shaded area indicates U.S. recession.

Source - RBC Wealth Management, Bloomberg U.S. Investment Grade & High Yield Corporate Bond Indexes

REGIONAL FIXED INCOME PERSPECTIVES

Fed rate cuts have boosted economic optimism as well as investor demand for riskier assets. Investment-grade bond yields are also historically rich relative to Treasury yields, offering investors just 0.89% of excess yields. We maintain an Underweight outlook on investment-grade corporates in favor of Treasuries. We hold a Neutral outlook for high-yield corporates, but if index yields were to drop below 6.5%, we would likely dial back our exposure in favor of higher-quality bonds.

Canada

- The Bank of Canada (BoC) has cut its policy rate by 75 basis points (bps) since June and suggested further rate cuts are likely if inflation continues to decline as it expects. Headline inflation slowed to the BoC's 2% target in August, for the first time since 2021, but core measures remain slightly higher. The BoC has put greater emphasis on downside risks to the economic outlook recently, noting it could cut interest rates slightly faster if growth doesn't pick up as the BoC expects. Recent indicators suggest Q3 GDP could disappoint relative to the BoC's July forecast, which in our view opens the door to a 50 bps rate cut later this year.

- Government bond yields have declined significantly over the past five months as the BoC cut its policy rate and amid growing expectations for U.S. Federal Reserve rate cuts, culminating in last month's 50 bps cut. The futures market now suggests the BoC will lower its policy rate to around 2.5% by the end of 2025 and the Fed to around 3.0%, both in the proximity of "neutral" rate estimates. In our view, BoC pricing is justifiable given a more challenging economic backdrop in Canada, whereas Fed pricing hinges on the U.S. economy slowing to a greater extent than the Fed assumes. That could leave the U.S. Treasury market vulnerable to a modest pullback, which would also push yields higher in Canada. As such, our previously positive view on longer-duration bonds, which benefit more when yields decline, has become more neutral.

- Canadian investment-grade credit spreads have widened modestly from year-to-date lows but remain slightly tighter than their 10-year average. Issuers have generally been able to absorb higher financing costs as maturing debt is rolled over, thanks to strong profit margins which have left interest coverage ratios close to their long-run average. That said, we continue to think compensation for taking on credit risk is relatively low given ongoing headwinds to Canada's economy. We recommend tactical investors evaluate their exposure to potential credit-spread widening, which would weigh on excess returns over government bonds.

United Kingdom

- Sticky services inflation will likely keep the Bank of England (BoE) in wait-and-see mode, so we do not expect a rapid interest rate cutting cycle at this stage. Our base case remains for one more 25 basis points (bps) cut this year at the November meeting, compared to the market's 41 bps forecast. The August Monetary Policy Report (MPR) states that, "services CPI inflation is expected to continue to ease only gradually over the course of this year, as wage growth weakens further." While wage growth is easing, labour costs remain an important driver for services inflation. We expect overall inflation pressures to moderate, but only progressively. If the October fiscal budget is deemed inflationary by the BoE, this could limit policy easing in 2025, in our view.

- We expect minimal disruption from the BoE's £100 billion balance sheet reduction over the coming year, given the small fraction of sales amounting to only £13 billion. Given the Labour government's promise of fiscal prudence, we are not expecting irresponsible fiscal measures at the October budget. Our base case is increased borrowing, based on the government's objective to stimulate

REGIONAL FIXED INCOME PERSPECTIVES

the economy through productivity-enhancing investments. Therefore, we refrain from adding long duration Gilts. We prefer the intermediate part of the Gilt curve, and we look to reduce our tactical Underweight as 10-year Gilt yields approach 4%. However, we remain quick to adjust positioning if yield curves continue to steepen.

- Corporate spreads could remain well contained in H2 with muted supply, and strong institutional and retail investor inflows. Leverage remains stable, thanks to steady earnings, albeit with higher financing costs, but with rate cuts on the horizon, we expect to see an improvement. Spreads in senior-ranking financial bonds appear less rich over a six-month range and there are idiosyncratic credit opportunities within subordinated financial bonds. Given the expected rate cuts on the horizon, we see opportunities across both cyclical and non-cyclical sectors, and across all investment-grade credit ratings.

Continental Europe

- The European Central Bank (ECB) risks falling behind the curve. While it hinted in September that there would be no policy change at its upcoming October meeting, we think recent inflation and economic activity data may push it towards a 25 basis points (bps) cut. We expect a further 25 bps of easing in December with the deposit rate reaching 3%, roughly in line with market expectations. As year-end approaches, the debate at the ECB will likely intensify as the hawks will place more weight on the sticky services inflation, while the doves will be closely watching the growth outlook. As the Olympics boost fades, weaker economic activity has resurfaced, more notably in the manufacturing sector, led by France and Germany. However, more positively, input prices are falling, leading to lower consumer prices. If the downward growth revisions in the September ECB staff forecasts are backed by actual downside surprises to growth, it will likely prompt a stepped-up easing pace in 2025 by the central bank, in our view.

- Demand for European government bonds has been strong despite heavy Q1 issuance, with a noticeable uptick in appetite from foreign and retail investors. We prefer Greece over Italy, and we balance the allocations across Germany, Spain, Netherlands, European Union, and regional agency bonds. We maintain an Underweight position in France given the heightened political and fiscal uncertainty.

- We expect minimal disruption from the central bank's reduction of corporate bonds on its balance sheet even as the ECB holds around 30% of the €1.18 trillion eligible corporate bond universe. In addition, investors have digested the record H1 gross supply of €305 billion in stride, and we expect demand to remain robust. Credit spread widening in the past quarter makes valuations less expensive based on one-year averages, and a better entry point, in our view. Despite higher earnings, leverage has increased in non-financial issuers; but more positively, financing costs are lowering gradually. Thus, we are selective on issuers and prefer exposure across the investment-grade spectrum with a balance of cyclical and non-cyclical exposure as the rate-cutting cycle evolves.

Asia Pacific

- We think Asian credit continues to offer attractive opportunities. We prefer investment-grade bonds as higher-quality Asian bonds have a history of being less volatile than their emerging market investment-grade peers. These bonds are also experiencing an increase in demand from domestic banks. In many Asian economies, local corporations and households have accumulated extremely large savings in recent years, empowering their domestic banks to increase Asian bond purchases. This, along with further compression of the U.S. Treasury

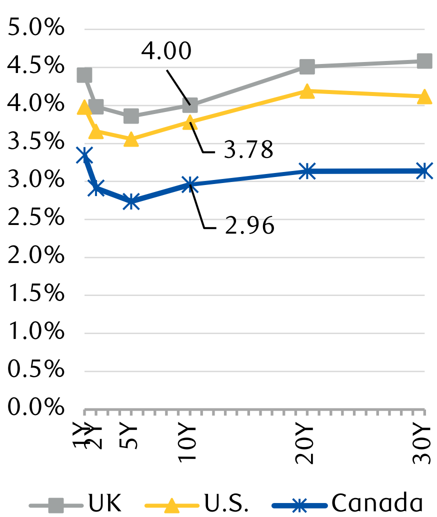
REGIONAL FIXED INCOME PERSPECTIVES

yields, will likely drive returns for bonds in the Asian space, in our opinion.

- We like bonds from Asia bank issuers, particularly bank capital securities, given their robust capital adequacy across markets, alongside maintaining a track record of redeeming their bank capital securities in the past 15 years. We also like bonds from strong South Korean financial institution issuers due to their relatively contained non-performing loans and household delinquency rates, and the support measures they enjoy from the government. The South Korean market also has a lower sensitivity to broad market risk than other Asian markets, which we believe makes it a good defensive opportunity when market volatility picks up.

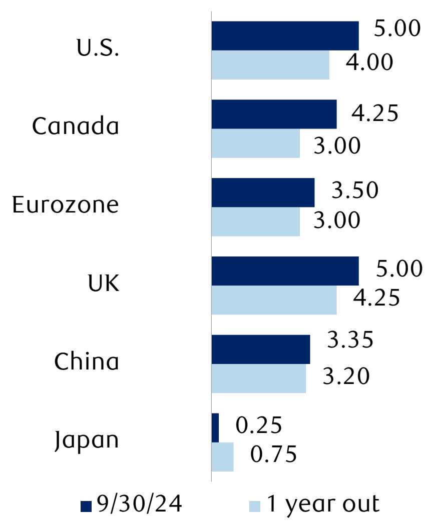
- In China, while its central bank (The People's Bank of China) has been providing funding support to the property sector through structural lending programs, the utilization rate of such programs has been low. We expect any rebound in Chinese property bonds will likely be short-lived, and we believe more work needs to be done on the fiscal policy front for a more sustainable turnaround in the sector to occur.

Sovereign yield curves



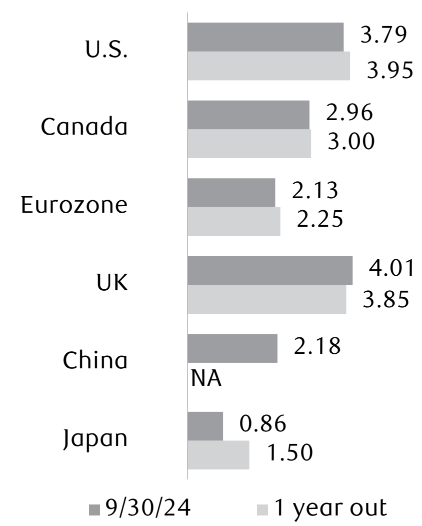
Source - Bloomberg; data through 9/30/24

Central bank rates (%)



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

10-year rates (%)



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

Commodities

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Crude oil

The price of oil has moved to the lower end of its trading range as a potentially over supplied market grapples with forecasts of lower demand. Deliveries in China have lagged 2023 levels with recent refinery utilization falling behind as well. Despite this recent weakness, RBC Capital Markets is projecting a West Texas Intermediate price of $76/barrel by year end.

Natural gas

Natural gas price drivers continue to teeter between supply and demand forces. The bears are pointing to higher-than-average inventories and ample production, while the bulls are focusing on the tactical production curtailments and lower-than-average storage injections. RBC Capital Markets sees further weakness and is forecasting $2.20/MMbtu by year-end.

Gold

Gold strength has persisted through the back half of 2024, and RBC Capital Markets believes this will continue. Amidst investor dollars still on the sidelines, the rate-cutting cycle continuing pace, and hard-landing worries across the U.S. and Canada, the continued demand for gold has reasonable rationale. RBC Capital Markets is projecting a gold price of $2,390/oz to end 2024.

Copper

Copper prices are down nearly 10% from the highs in May as a slowing global economy, including weak growth out of China, weighs on demand. Near-term catalysts to ignite a move higher are hard to see by year-end, in our view, but we remain constructive on the longer-term drivers of the commodity, which includes energy transition, EVs, and onshoring of production.

Soybeans

According to the USDA, soybean crops have benefited from near-optimal weather resulting in 68% of the U.S. soybean acreage receiving a high-quality rating. In turn, this has boosted the U.S. soybean production forecast for 2024/2025 with Bloomberg consensus forecasting $11.23/bu by year-end.

Wheat

The U.S. Department of Agriculture (USDA) is forecasting wheat production for 2024/2025 to be 9% higher year over year, the largest in eight years. Global wheat production is also forecast to be a record, as favorable weather during the growing season has contributed to healthy crop conditions. Bloomberg consensus forecasts see $5.85/bu by year-end.

Commodity forecasts

Commodity	2024E	2025E
Oil (WTI $/bbl)	76	68
Natural gas ($/MMBtu)	2.20	3.13
Gold ($/oz)	2390	2835
Copper ($/lb)	4.17	4.5
Soybeans ($/bu)	11.23	11.50
Wheat ($/bu)	5.85	6.15

Source - RBC Capital Markets forecasts (oil, natural gas, gold, and copper), Bloomberg consensus forecasts (soybeans and wheat); data as of 9/27/24

Chart source - RBC Wealth Management, Bloomberg; data range 4/27/23–9/27/24

Currencies

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U.S. dollar: Fed shifts focus from inflation to job growth

The U.S. Dollar Index (DXY) fell by about 4.5% in Q3 as investors priced in aggressive interest rate cuts by the Federal Reserve, where policymakers' focus shifted from inflation to employment. With the Fed starting its rate cut cycle, RBC Capital Markets has nudged down its U.S. dollar forecasts but stopped short of turning bearish absent the appearance of clearer signs of recession. A potential Trump presidency would likely bring new tariffs, which would be an upside risk for the greenback.

Euro: EUR/USD above 1.10

The EUR/USD pair rose above 1.11, driven mostly by a broadly weaker dollar in Q3 than by positive news out of Europe. European manufacturing data point to ongoing weakness, and while the services sector is expanding, Q2 growth was still low at 0.2% q/q. RBC Capital Markets sees EUR/USD at 1.12 in Q4 2025, with upside risk to 1.20 should there be a U.S. recession, while downside risk exists on a potential Trump presidency that would likely bring more aggressive tariffs.

Canadian dollar: USD/CAD peak lowered

The Bank of Canada (BoC) delivered a third consecutive 25 bps rate cut in September, in line with market expectations. It kept the door open to more cuts. RBC Economics sees the BoC cutting rates by a total of 125 bps until end-2025, similar in magnitude to the Fed, but with the BoC already cutting three times in 2024, we think the relative rate dynamics still favor the greenback, with some upside risk to USD/CAD into early next year.

British pound: Autumn Budget in October as next catalyst

The GBP/USD pair rose despite the Bank of England delivering its first rate cut of the cycle in August. RBC Economics expects economic growth in the UK to slow in H2 2024 and thinks the pound faces more downside than upside risk, with the currency remaining overvalued on a real effective exchange rate basis from a historical perspective. Investors will be watching the Autumn Budget on Oct. 30 as the next event risk for the pound.

Japanese yen: Sharp drop in USD/JPY

The aggressive rate cut expectations from the Fed, two hikes from the Bank of Japan, and an unwinding of the popular "carry trade" theme (where investors borrow the yen at low yen interest rates to invest in the higher interest-bearing U.S. dollar) have seen the USD/JPY pair drop sharply from 160 to 140 in Q3. We expect USD/JPY to remain above 140 in Q4, but the yen could strengthen if the Fed is forced to cut rates faster than markets are pricing.

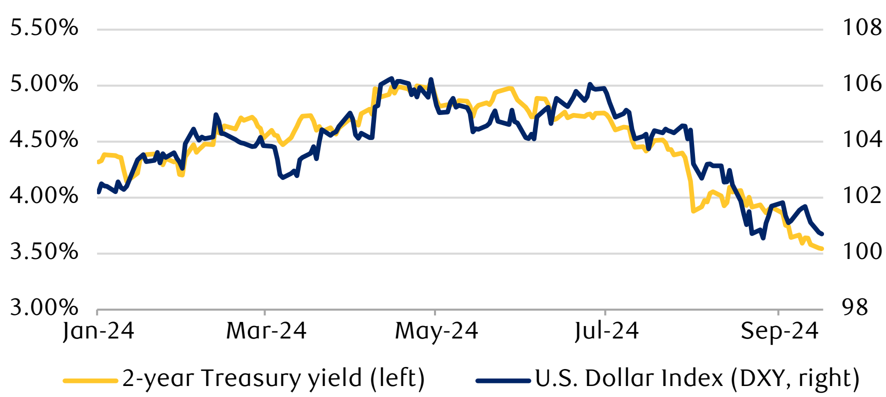
Currency forecasts

Currency pair	Current rate	Forecast Sept. 2025	Change
Major currencies			
USD Index	100.78	102.24	1%
CAD/USD	0.74	0.73	-1%
USD/CAD	1.35	1.37	1%
EUR/USD	1.11	1.11	0%
GBP/USD	1.34	1.25	-7%
USD/CHF	0.85	0.95	12%
USD/JPY	143.63	143.0	0%
AUD/USD	0.69	0.71	3%
EUR/JPY	159.94	159.0	-1%
EUR/GBP	0.83	0.89	7%
EUR/CHF	0.94	0.95	1%
Emerging currencies			
USD/CNY	7.02	7.05	0%
USD/SGD	1.29	1.28	-1%

Change is defined as the implied appreciation or depreciation of the first currency in the pair quote.

Source - RBC Capital Markets forecasts, Bloomberg

DXY has dropped to a new year-to-date low as the Fed starts its interest rate cut cycle

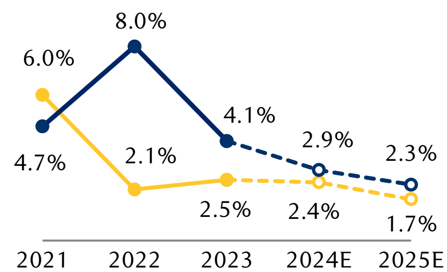


Source - Bloomberg, RBC Wealth Management; data through 9/17/24

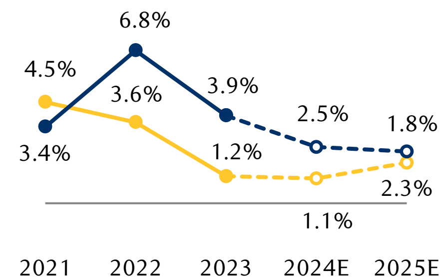
KEY

Forecasts

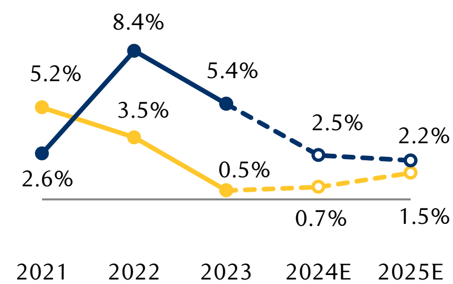
United States



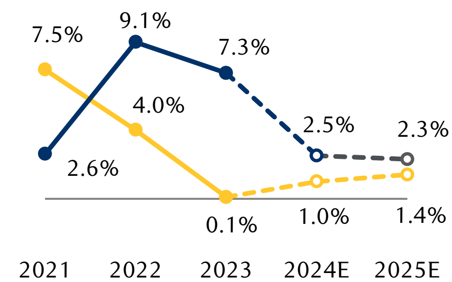
Canada



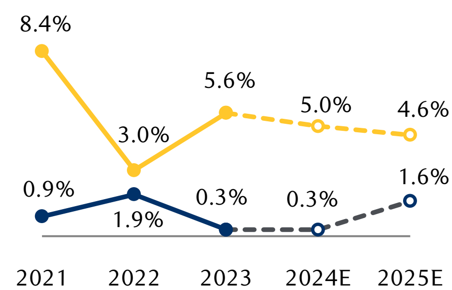
Eurozone



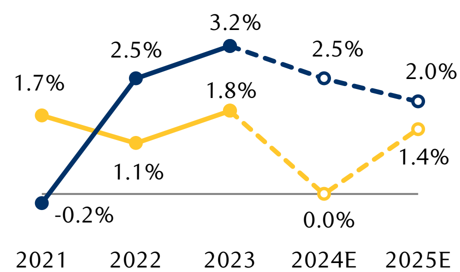
United Kingdom



China



Japan



Real GDP growth

Inflation rate

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

Research resources

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As of September 30, 2024

			Investment Banking Services Provided During Past 12 Months	
Rating	Count	Percent	Count	Percent
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Hold [Sector Perform]	599	40.07	153	25.54
Sell [Underperform]	38	2.54	3	7.89

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