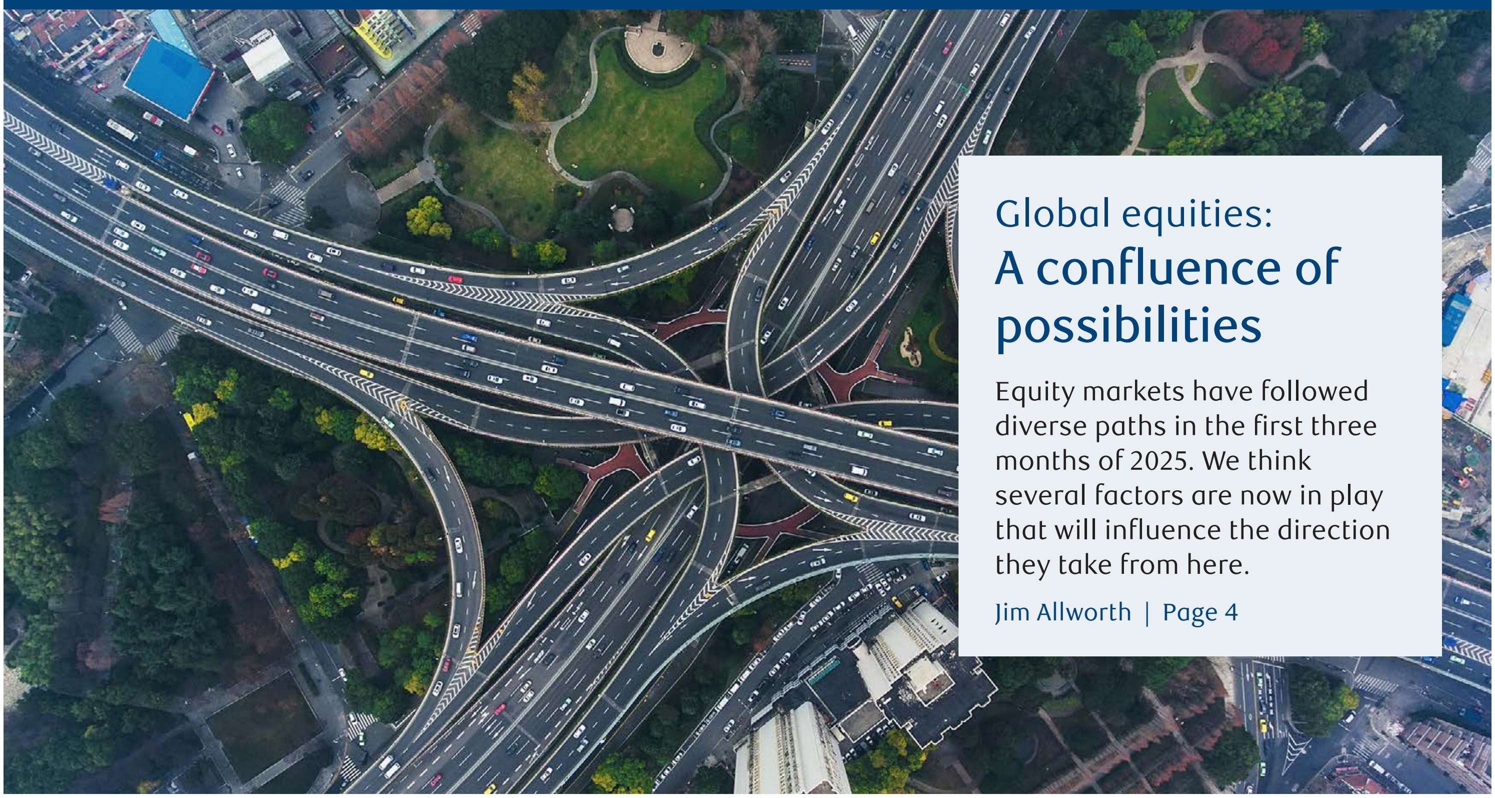
GLOBAL

Insight

April 2025

Wealth Management

Perspectives from the Global Portfolio Advisory Committee



Global equities: A confluence of possibilities

Equity markets have followed diverse paths in the first three months of 2025. We think several factors are now in play that will influence the direction they take from here.

Jim Allworth | Page 4

Also in this issue

GLOBAL FIXED INCOME

It’s a topsy-turvy world

COMMODITIES

Crude oil: Prices under pressure

CURRENCIES

U.S. dollar: Sentiment turns bearish

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For important and required non-U.S. analyst disclosures, see page 21.

GLOBAL

Insight

April 2025

Contents

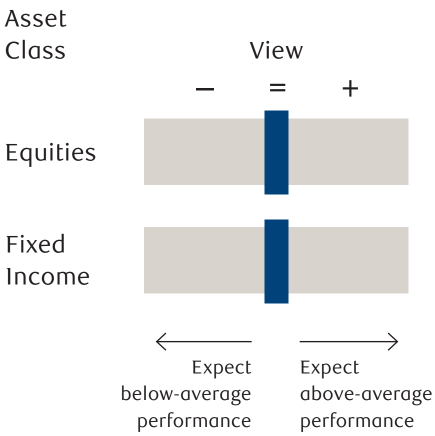
In the markets

All values in U.S. dollars and priced as of market close, March 31, 2025, unless otherwise stated.

RBC'S INVESTMENT

Stance

Global asset class views



(+/=/–) 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

- Equity markets are grappling with ultra-high levels of uncertainty regarding U.S. policy and potential economic outcomes. The wide discrepancy between deteriorating consumer and business sentiment and resilient hard data (such as retail sales) is challenging for equity investors to interpret. The Q1 reporting season that kicks off in late April will give some clues as to prospects for the economy and the corporate sector, but global equity markets will have to digest the announcement of new U.S. tariff policies before then. For now, consensus forecasts see mid-to-high single-digit earnings growth for 2025, slightly less than they were hoping for earlier in the year.
- Increased volatility in global equity markets over the short term is thus likely. Whether the S&P 500 and other major equity indexes can advance will depend on a meaningful scaling back of trade issues that would limit economic damage.
- For now, we believe investors should remain cautious, watchful, but invested. We would ensure our stock holdings have staying power and are best positioned to perform throughout the business cycle.

Fixed income

- Global bond yields faced a bout of volatility in Q1 as uncertainty and shifting global dynamics upended the status quo. But the volatility, and a broadly attractive yield environment globally, allowed us to reposition accordingly.
- We shifted to an Overweight position in U.S. Treasuries paired with an Underweight for global developed bonds. Slowing growth in the U.S. will likely mean a resumption of rate cuts from the Federal Reserve this year, in our view; globally, the picture remains muddy. Increasing scope for fiscal spending in Europe could mean the European Central Bank delivers fewer rate cuts than previously expected, while the Bank of Japan looks poised to continue raising rates. All told, global sovereign yields could trend modestly higher.
- We reiterate our Market Weight stance on U.S. fixed income with yields remaining above multi-decade averages. Credit valuations remain historically rich globally despite the recent widening of credit spreads, which leads us to continue favoring sovereign bonds over corporate bonds.

MONTHLY

Focus

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

Global equities:
A confluence of possibilities

Global equity markets have followed diverse paths in the first three months of 2025, from corrections to new highs, all against a backdrop of deep economic uncertainty. While we see potential for equities to perform well going forward, we think several factors are now in play that will influence the direction markets take from here.

Key points

- **The S&P 500 did much better in the rally that followed the U.S. election than major non-U.S. equity markets, but much worse in the recent correction. Investor sentiment has become one-sidedly pessimistic.**
- **An oversold rebound may arrive in the coming weeks, but moving on to sustainable new highs could require a re-energised earnings picture catalysed by a meaningful scaling back of trade issues.**
- **Most importantly, the U.S. needs to avoid recession. If it fails to do so, most equity markets are likely to face weaker earnings and share prices than they have experienced so far.**

Major stock markets spent much of February and March either correcting (the S&P 500 and other U.S. large-cap indexes) or easing back from recent highs (Canada's TSX and Japan's TOPIX) or putting in new highs (the MSCI Europe and UK indexes). The standout over the past few months has been China's Hang Seng racing to a succession of new cycle highs, admittedly from very depressed lows.

The S&P 500 became oversold by several measures, enjoyed a welcome rebound rally for a couple of weeks, and then retreated again. Whether a more sustainable rally will develop soon that could reach yet another new high remains an open question. It could also be no more than a brief upside interlude, to be followed quickly by some further downside.

Here are a few things to consider. From its all-time high in mid-February, the S&P 500 Index retreated by almost 11 percent at its lowest point. That would make it a garden-variety pullback in the view of Lori Calvasina, RBC Capital Markets, LLC's head of U.S. equity strategy. What's perhaps most noteworthy is that over just six weeks some well-watched gauges of investor sentiment swung from too complacently bullish all the way to very—and probably unsustainably—bearish.

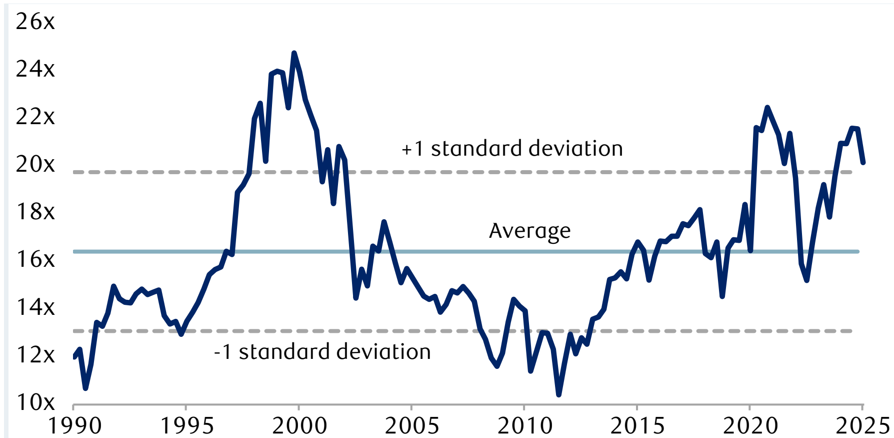
One such indicator, the weekly Sentiment Survey by the American Association of Individual Investors, has recently hit depressed lows from which Calvasina points out the S&P 500 has generated average returns in excess of 10% over both nine-month and one-year holding periods.

A CONFLUENCE OF POSSIBILITIES

It would be easier to accept and act on these bullish probabilities if valuations (price-to-earnings multiples or P/Es) had fallen to compelling levels, but they haven't. The forward P/E for the S&P 500, after peaking at 22.8x as the market reached an all-time high in February, has settled back to 20.4x; most would regard this as still rich compared to its long-term average of 16x.

The median P/E within the version of the S&P 500 that excludes the 10 companies with the largest market capitalisations (which largely eliminates the distorting impacts of the high-flying mega-cap growth stocks) has fallen to a more palatable 17.2x, but that valuation level is also above its long-term average of 15x.

S&P 500 price-to-earnings ratio based on forward consensus estimates



Source - RBC Wealth Management, Bloomberg; quarterly data through 3/31/25

Markets can rally meaningfully from less-than-compelling valuations, but it helps if the underlying fundamental earnings picture is improving—or at least not open to serious question. Of course, today's ultra-elevated level of policy and economic uncertainty does just that: raise questions about the durability of the earnings outlook.

In the U.S., management confidence is very much in flux, and we suspect the same is true elsewhere. The three months following the U.S. election featured surging CEO optimism about the future, as reported in several well-regarded surveys. But the latest survey undertaken by *Chief Executive* magazine in early March revealed a sharp reversal in CEO sentiment, giving back all the post-election gains—and then some—to produce the lowest reading since November 2012. Of the CEOs surveyed, 48 percent said they expected a recession or slowdown within six months. Their sidekicks, chief financial officers, have become even more pessimistic: 60 percent of CFOs in a CNBC survey said they expect a recession in the second half of the year. Just one quarter ago only seven percent thought a recession would arrive in 2025.

Both groups say the high level of uncertainty means decisions about pricing, hiring, and capital spending are much harder to make with confidence.

A CONFLUENCE OF POSSIBILITIES

Current valuations of major equity indexes versus long-term averages

Index	P/E on forward earnings	Long-term average
S&P 500	20.4x	16.0x
S&P/TSX	15.2x	14.7x
MSCI Europe	15.5x	13.6x
MSCI UK	11.2x	12.3x

Source - RBC Wealth Management, Bloomberg; data as of 3/28/25

All this fast-rising pessimism could fade away, perhaps as quickly as the post-election enthusiasm mounted. But not overnight. The next important management pulse-taking will get underway in late April as part of the Q1 reporting season. As things stand, we expect that many CEOs will be reluctant to give forward guidance for upcoming quarters, just as they were at the start of the year. Unwillingness to give guidance is rarely interpreted by investors as a positive signal.

So, in the absence of greater clarity, the consensus 2025 earnings estimate for the S&P 500 may be increasingly vulnerable to downward revision. It has already come down by about two percent from the $274 per share where it began the year (which was itself down from a $280 high-water mark set last August). It now sits at $269.

Index earnings estimates typically erode by about five percent over the course of the year. That would put 2025 earnings at something around $260, representing an increase of roughly six percent over 2024's $245 per share. An erosion in growth expectations of that magnitude would not pose a problem for the market, in our opinion, as long as investors could confidently expect a reacceleration of earnings growth in 2026. And the market's latest pullback seems to have already priced in the likelihood of that scale of earnings revision. A meaningfully deeper price retrenchment than the S&P 500 has already experienced would probably require a growing percentage of investors and forecasters on the Street to join with CFOs and CEOs in expecting a U.S. recession.

By and large, the forecasters are so far not subscribing to that idea. Most were prompted by evidence of Q1 weakness to lower their full-year U.S. GDP growth estimates to something either side of two percent, but few forecasts of outright recession have surfaced. Consumer and management pessimism about the economic outlook isn't the same as cutting spending, which has mostly held up for both households and businesses.

In our view, there are plausible paths to new highs for the S&P 500 and other major equity markets. The first requirement would be a catalyst to bring buyers back into the dominant position in the U.S. equity market. We suggested two in this space last month: a peace treaty, ceasefire, or any other agreed downshifting of the Russia-Ukraine conflict; and meaningful scaling back of trade issues.

The latter would be the most important, and would have to be sufficiently impactful to produce changes in several areas: reducing inflationary pressures enough to put rate cuts back on the table for the Federal

A CONFLUENCE OF POSSIBILITIES

Reserve; giving businesses confidence to plan, hire, and spend on capex; and boosting consumer confidence by reducing job insecurity.

There is also a necessary condition: the U.S. needs to avoid recession. If it doesn't, we think an earnings valley is likely to open up that will eventually take share prices lower than they have been so far.

We have repeatedly emphasized the need to have the market's direction validated by measures of market breadth such as the advance-decline line and the unweighted version of the S&P 500 Index. This is becoming all the more important, in our view, as the recent pullback has raised concerns that a deeper stock market retrenchment may lie ahead if the economy falters.

The jury is still out on this issue. After leading the S&P 500 Index higher all through the powerful market advance from October 2022 to December of last year, those breadth measures have failed to confirm either the January or February all-time highs posted by the S&P 500. They appear close enough to doing so that we believe it's worth waiting to see if the next rally is accompanied by broad enough participation to get the job done.

Meanwhile, we think this confluence of possibilities calls for investors to remain cautious, watchful, but invested. We are intent on limiting our buying to stocks that have staying power and companies with the least to lose if a recession does materialise.

Regional equity perspectives

Matt Altro, CFA
Toronto, Canada
matt.altro@rbc.com

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

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

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

Nicholas Gwee, CFA
Singapore
nicholas.gwee@rbc.com

With global equity markets grappling with ultra-high levels of U.S. policy and economic uncertainty, increased levels of volatility in global equity markets in the short term are likely. At times of great uncertainty, Market Weight positions can be effective. We review prospects for the various regions and highlight factors to watch going forward. For a full account of our thinking, see this month's focus article, "A confluence of possibilities."

Equity views

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

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

United States

- The Q1 consensus U.S. GDP growth forecast has retreated to 1.2% recently from 2.1%, and growth could fall short of this lower forecast when the preliminary data is reported on April 30. Tariff fears have weighed on consumer, business, and investor sentiment, and there are signs this has prompted a pullback in spending overall. Some of the economic weakness also may be due to the normal aging and maturation of the business cycle. The expansion has lasted for 59 months, near the long-term average since 1933.

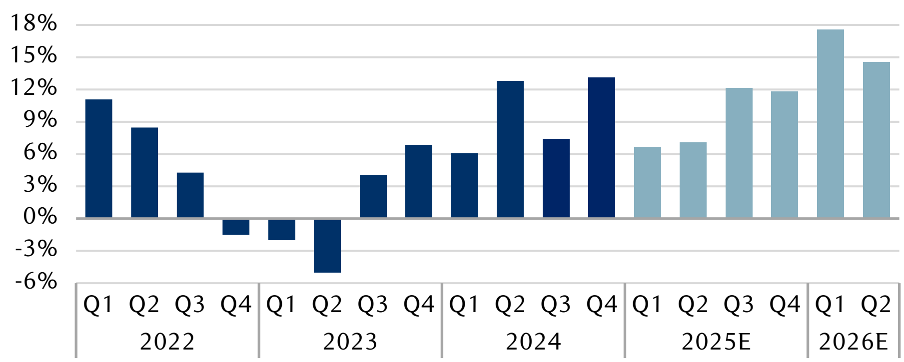
- RBC Economics recently lowered its full-year 2025 U.S. GDP growth forecast to 1.6% from 2.0%, and RBC Capital Markets reduced its S&P 500 earnings forecast for the year to $264 per share, below the $269 per share Bloomberg consensus forecast. Concerns about earnings and economic growth, along with many Washington policy uncertainties, are the main reasons the S&P 500 recently declined 10% from its all-time high reached in mid-February.

- Historically, the sweet spot for U.S. equities has been when annual GDP growth has registered between 2.1% and 3.0%—the so-called "Goldilocks" level, not too hot and not too cold. This tends to support solid corporate revenue and profit gains, as well as capital investment and innovation. But when GDP growth slips to the 1.0% to 2.0% range—as RBC Economics is now projecting—the market can struggle at times as sales, earnings, and capital investment tend to be muted.

- Given the economic vulnerabilities and policy risks, we think U.S. equity exposure should be held up to but not beyond the long-term strategic allocation level—in other words, up to a Market Weight level, but

Earnings growth estimates look too rosy for this year and next

S&P 500 quarterly earnings growth (year over year)



Dark blue bars are actual values; light blue are consensus estimates.
Source - RBC Wealth Management, Bloomberg; data as of 3/24/25

REGIONAL EQUITY PERSPECTIVES

not at an Overweight level. It's also prudent to tilt portfolio holdings more toward quality stocks, in our view. These are represented by companies with strong balance sheets and financial flexibility, led by experienced management teams who have weathered business cycle shifts before. Within this category, we favor dividend growers and steady earnings growers, specifically "growth at a reasonable price" or "GARP" stocks.

Canada

- Despite higher inflation and the evolving tariff policy actions of the White House, the S&P/TSX Composite Index (TSX) has held up quite well. February inflation data showed a firmer-than-expected 2.6% year-over-year increase. But since the Bank of Canada's 25 basis point cut in early March brought the policy rate to 2.75%, we think the path to further interest rate reductions has become more complicated.

- The total impact of tariffs on the Canadian economy remains unknown, largely due to the fluidity of the U.S. administration's approach, but what we can confirm is that the longer tariffs stay in place, the larger the negative impact on Canadian consumers. The political uncertainty is not just one-sided, as we now have a snap election set for April 28; recent polling indicates the Liberals and Conservatives are in a tight race, adding to the market's ambivalence.

- Depending on how tariff policy plays out, relative outperformers and underperforms are likely to emerge amongst industries and sectors that typically tilt either more offensively or more defensively. A less intrusive and shorter-lived tariff scenario could see investors lean more into offensive and economically sensitive (cyclical) equities such as banks, energy producers, transports, and consumer discretionary stocks. On the other hand, if tariffs remain in place for a significant period, the Canadian equity market would likely be supported by funds flowing into defensive areas like gold stocks, energy infrastructure, waste handlers, and utilities. Gold stocks, representing a high-single-digit weighting in the TSX, have been a consistent source of strength propping up index performance year to date. Due to a combination of large central bank purchases, falling interest rates, and a softening economic outlook, the price of gold reached all-time highs earlier in the year without much retracement since.

- Looking forward, we continue to see opportunities in the Canadian equity market reinforced by a TSX valuation that, although modestly above its long-term average, still trades at a deep discount to the S&P 500. We maintain caution on the health of the Canadian consumer and look for resilience in overall TSX earnings to support current valuations.

United Kingdom

- The UK economic environment continues to be one of tepid growth. Consensus 2025 GDP growth estimates have come down from 1.5% late last year to 1% currently as the government's fiscal restraint takes hold. This may enable the Bank of England (BoE) to continue to lower interest rates, but inflation worries remain dominant for now. The lack of a dovish pivot from the BoE has kept the pound well underpinned for now.

- Reciprocal tariff risk looms over the UK though any impact may well be contained. The country has a relatively low trade surplus with the U.S., and manufacturing represents less than 10% of GDP.

- For large-cap equity investors, the domestic issues are not important drivers, in our view, because more than three-quarters of FTSE 100 companies' revenues derive from abroad. These issues do tend to have a more pronounced impact on the bond market, and small-cap equities.

- UK equities typically perform well amid global financial market volatility given the oversized representation of defensive sectors, such as Consumer Staples, Utilities, and Health Care.

REGIONAL EQUITY PERSPECTIVES

■ UK valuations remain close to all-time low levels compared to other markets. The FTSE All-Share Index is trading well below its long-term median price-to-earnings ratio relative to global developed markets, even accounting for sector differences.

■ Though we currently suggest a modest Underweight in UK equities, we continue to believe that quality UK large-cap stocks which trade at a valuation discount to peers listed in other markets are an attractive opportunity for global investors.

■ Among domestically exposed stocks we favour Financials, reflecting their attractive valuations and high level of shareholder returns via both dividends and share buybacks.

Europe

■ Seismic changes are taking place in Europe. Prompted by signs that the traditional U.S. security support could be withdrawn or downsized, the German Parliament recently passed landmark fiscal reform measures. The country is now poised to enter a new phase, in our view, moving beyond a period in which fiscal constraints stifled growth and undermined competitiveness.

■ The German fiscal package includes a special fund for infrastructure investments of as much as €500 billion (or 12% of GDP) over the next 12 years. Transport, hospitals and care, energy, education, digitization, and R&D are all targeted. The limit on structural deficits has also been relaxed to allow for higher defence spending, a measure that effectively leaves defense spending unconstrained.

■ Meanwhile, the European Commission has proposed a plan to address deficiencies in the region's defence capabilities by 2030, with funding of as much as €800 billion. This includes €150 billion of joint EU loans for defence investment and the exemption of defence spending from EU deficit rules. European Union leaders will now seek approval for the plan in their own countries.

■ Overall, modest real income growth as inflation subsides, the German fiscal package and the ReArm Europe plan (subsequently rebranded as Readiness 2030) could boost eurozone GDP growth by roughly half a percentage point per year, bringing GDP growth to 1.9% and 1.8% in 2026 and 2027, respectively, according to RBC Capital Markets. This assumes defence spending can reach 3% of GDP by 2030—a tall order, in our view.

■ The bloc's structural issues, including a lack of investment by Germany, have been a key reason for global investors' caution towards the European stock market in prior years. Recent developments suggest

European equities' recent outperformance should be viewed in the context of long-term underperformance

MSCI Europe ex UK Index relative to MSCI World Index (local currency)

Data indexed to 3/30/15 = 100%.

Source - RBC Wealth Management, Bloomberg

REGIONAL EQUITY PERSPECTIVES

that the EU may be ready to tackle those issues, acting with urgency and cohesion. We now suggest a Market Weight position in the region, up from an Underweight. This new positioning better reflects the improved outlook, while acknowledging that the looming threat of U.S. tariffs could lead to volatility.

- Despite rallying year to date, European equity valuations relative to U.S. and global equity valuations remain close to an all-time low on a sector-adjusted basis. Being selective is key for this region, in our view, and we continue to prefer world-leading companies positioned to benefit from and enable structural global trends—particularly in the areas of technology, health care, and industrials, including defence.

Asia Pacific

- Chinese equities rallied strongly in Q1. We believe three factors will determine whether the rally will be sustained: tariff risks, policy clarity, and economic/earnings recovery. The challenges associated with the first two factors appear to have been largely cleared, in our view.

- Tariff risks have so far been less onerous than initially feared, as markets had priced in a worst-case scenario. During the previous round of U.S.-China trade tensions in 2018, tariffs weighed more on sentiment than on company earnings. Currently, companies in the MSCI China Index generate 87% of their revenue domestically, with just 3% from the U.S. While tariffs will likely remain an overhang, the negative impact on the market may be smaller than investors expect.

- Government policy clarity emerged from the “Two Sessions” gathering of top decision makers in early March, and broadly aligned with investor expectations. The official target of “around 5%” GDP growth indicates that further stimulus is likely, in our view, and the recent announcement of guidelines intended to improve consumer confidence reinforces the government’s focus on boosting domestic consumption.

- Looking ahead, we think market attention will shift to corporate earnings and economic momentum. The earnings revision trend has held up well since Q4 2024, and upward earnings revisions could support further equities upside. However, consolidation is likely in the near term as investors await data confirming the economic recovery has traction.

- Japanese equities have underperformed most developed markets year to date due to a variety of factors including uncertainties about aggressive U.S. tariff tactics, rising expectations for further interest rate hikes by the Bank of Japan, the strengthening of the yen, and softening domestic consumer and investor sentiment.

- We expect Japan’s inflation to peak in 2025 and remain well above the deflation danger zone in 2026; the Bloomberg consensus Consumer Price Index forecast calls for a 2.6% increase in 2025 and 1.9% in 2026. We anticipate real GDP growth of roughly 1% per annum in 2025, 2026, and 2027, similar to the Bloomberg consensus forecast and above the five-year average of 0.2%. In 2025, consumer sentiment should be supported by a third consecutive year of wage hikes. Lastly, apart from the auto sector, we believe Japan’s economy will experience a relatively mild impact from U.S. tariffs, as Japan has been the biggest foreign investor in the U.S. for the past five years and has been working to double the ratio of defence spending to GDP.

- Overall, we maintain our constructive view on Japanese equities for several reasons. A sustainable 2% inflation target seems in sight; friend-shoring and onshoring trends support renewed investment; return-on-equity and shareholder returns are improving; resilient domestic demand is supported by high savings and wage hikes; inbound tourism looks positive; and the revamped Nippon Individual Savings Account scheme has produced elevated domestic retail inflows.

GLOBAL

Fixed income

Thomas Garretson, CFA
New York, United States
tom.garretson@rbc.com

It's a topsy-turvy world

Fixed income views

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

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

The first quarter of 2025, perhaps unsurprisingly, proved to be a rather volatile one. But that is not to say the year started without surprises, as certain preconceived notions about global fixed income markets in 2025 have been flipped upside down.

First, the broad narrative that supercharged growth expectations in the U.S. based on business optimism, deregulation, and potential tax cuts would keep the Federal Reserve on hold, and Treasury yields elevated, has faded as economic growth concerns have reemerged—putting interest rate cuts and lower Treasury yields back on the horizon.

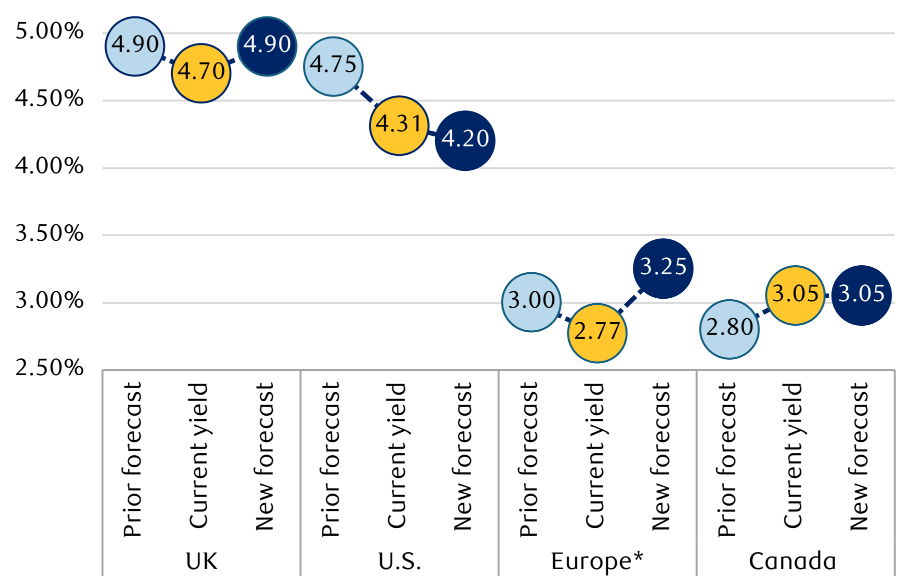
Whereas markets had previously questioned whether the Fed would cut rates at all this year, they are now fully priced for two 25 basis point cuts (in line with current Fed projections) and the chances of a third rate cut have risen substantially as we approach the end of Q1.

Second, the notion of "American exceptionalism" as it relates to many global developed markets and economies has dissipated. The idea that slower growth globally would lead most central banks to maintain an easing bias has already hit a blockade as increased fiscal largesse and military spending raises the prospect that the European Central Bank could already be at, or near, the end of policy easing in the face of better growth prospects.

Largely as a result of these shifts, RBC Capital Markets analysts slashed their year-end U.S. Treasury yield

U.S. yields have a downward bias, while global yields could edge higher

Recent revisions of 10-year sovereign yield forecasts for Q4 2025



RBC Capital Markets forecasts as of February 2025 (prior) and March 2025 (new).
* European yields represented by German Bunds.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; current yields as of 3/24/25.

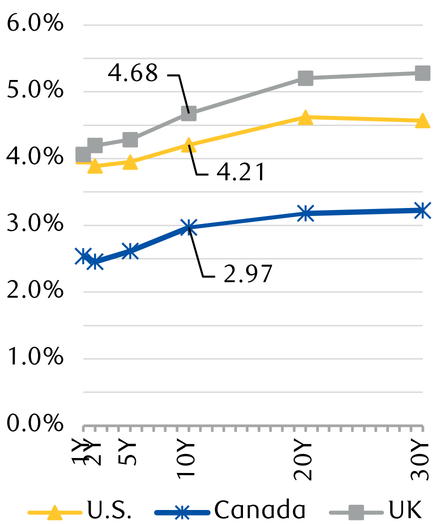
GLOBAL FIXED INCOME

forecasts in March while modestly upgrading their views for the rest of the world. The changes from prior forecasts, relative to current 10-year sovereign bond yields, are summarized in the chart below.

The net result is that we have turned more favorable on U.S. debt, seeing current yield levels as offering generally attractive entry points. Globally, we believe the recent spike in yields driven by revised fiscal spending plans may have slightly overshot reality, perhaps offering buying spots on a tactical basis even if the longer-term trend toward moderately higher yield levels continues.

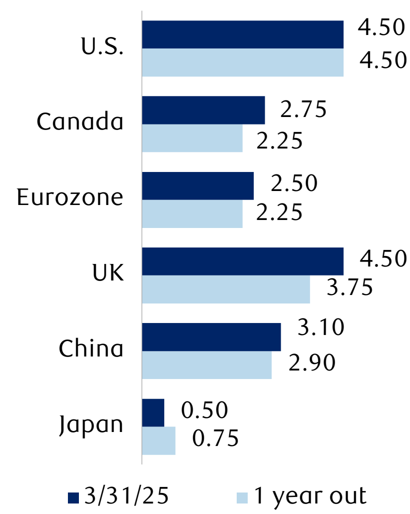
What has not changed is that global credit markets remain historically rich, despite Q1 selling pressures that did serve to moderately cheapen valuations. With this in mind, and amid an environment of heightened volatility, we would keep the bias toward sovereign bonds over credit in portfolios.

Sovereign yield curves



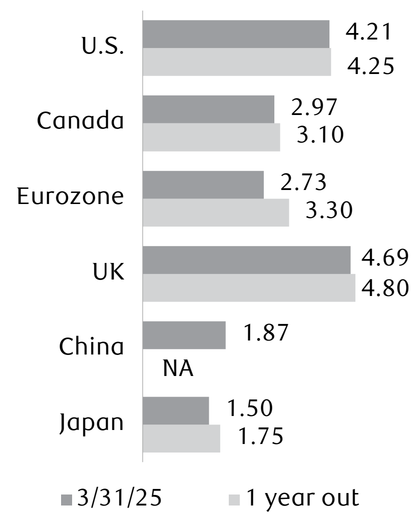
Source - Bloomberg; data through 3/31/25

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

Regional fixed income perspectives

Luis Castillo
Toronto, Canada
luis.castillo@rbccm.com

Rufaro Chiriseri, CFA
London, United Kingdom
rufaro.chiriseri@rbc.com

Thomas Garretson, CFA
New York, United States
tom.garretson@rbc.com

Shawn Sim
Singapore
shawn.sim@rbc.com

United States

■ The Federal Reserve kept interest rates on hold through Q1 after consecutive rate cuts to close out 2024, but markets are increasingly pricing the likelihood that the central bank won't stand pat much longer. Expectations for a resumption of the rate cut cycle are building, with markets seeing the next cut as early as this quarter. The Fed's economic projections at the March meeting raised the daunting specter of stagflation risks for the U.S. economy this year—a situation where inflation is rising amid slowing economic growth. That puts policymakers in a precarious spot, but in our view (and based on Fed Chair Jerome Powell's comments in March) we believe the Fed would err on the side of cutting rates should growth slow more than expected, even if inflation were to remain elevated. We see rising chances that the Fed could cut rates again by the June meeting.

■ Amid rising inflation risks and slower growth expectations, traders are seemingly struggling to determine where the benchmark 10-year Treasury yield goes next. It has traded as high as 4.80% this year, and as low as 4.10%, ending Q1 at 4.21%. Given the current heightened economic uncertainty, we think it is likely to hold within that range in Q2, ultimately with a bias towards lower levels as the prospects of slower growth should outweigh risks of elevated inflationary pressures.

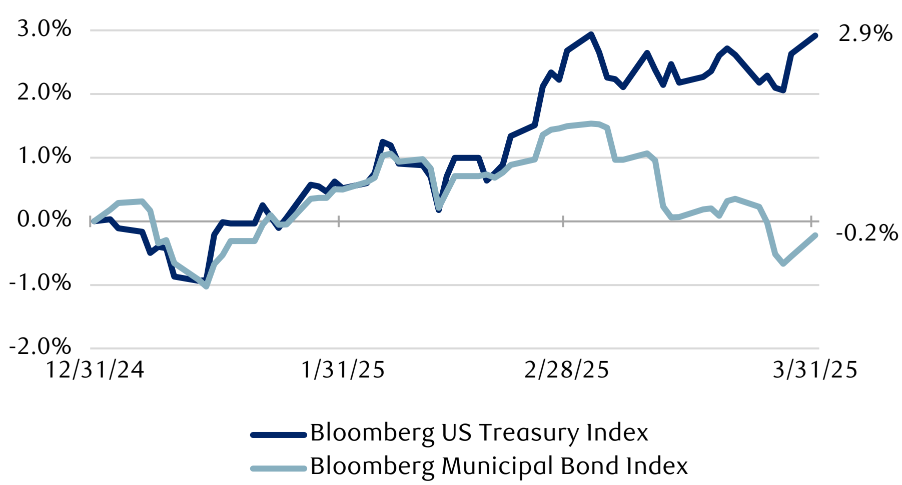
■ Questions about the durability of the tax-exempt status of municipal bonds under the new administration has caused the municipal bond market to notably underperform Treasuries this year. The Bloomberg US Treasury Index has gained 2.9% year to date, while the Bloomberg Municipal Bond Index has lagged since February and is down 0.20% on the year. While the outcome remains highly uncertain, our base case is that munis ultimately maintain their tax-exempt status—and if nothing else, the concerns have helped bring muni yields up to levels we view as some of the most attractive relative to Treasuries that in recent years.

Canada

■ Though recent economic data has been stronger than previously expected by economists on the Street, trade policy uncertainty has the potential to hit the brakes on recent momentum. In fact, sentiment data is already showcasing the harm inflicted on both consumers and businesses. A recent Bank of Canada (BoC) opinion survey suggests that a large percentage of Canadians expect

Municipal bonds lag Treasuries as concerns about tax-exempt status rise

Total return performance of U.S. Treasury and municipal bond indexes in Q1 2025



Source - RBC Wealth Management, Bloomberg; data through 3/31/25

REGIONAL FIXED INCOME PERSPECTIVES

the cost of living to increase, and with good reasons. It also revealed that about half of businesses plan to pass on the anticipated tariff-induced increase in costs to consumers.

- Whether the hard economic data will corroborate the soft survey data is yet to be seen, leading to what we consider to be a blurrier outlook for what has become a "data-dependent" BoC, and by extension, a blurrier outlook for rates. Formulating a reliable economic forecast in this environment is difficult, in our view. The BoC looked for a buffer against future economic weakness by easing monetary policy further and delivering a seventh consecutive rate cut in March. We think the central bank will likely take a wait-and-see approach before adjusting monetary policy further as it assesses both the upward pressures on inflation from higher costs and the downward pressures from weaker consumer demand.

- Corporate bond spreads, which measure the additional yield demanded by corporate bond investors over government bonds as compensation for default risk, have not been immune from recent risk-off sentiment. The credit spread on the Canadian Corporate Bond Universe has widened by roughly 13 basis points year to date. In the context of a corporate credit market that has remained surprisingly resilient for the better part of two years, recent moves—even if only modest—are worth paying some attention to. We do expect some degree of negative repricing over the near term, and as such have continued to source bond exposure within the higher-quality—investment grade—categories. Nonetheless, we see bond yields as broadly attractive from a historical perspective and view today's yields as providing a decent cushion against further uncertainty.

United Kingdom

- The Bank of England (BoE) has committed to a "careful and gradual" approach given the challenging combination of inflation concerns and a deteriorating growth outlook. Our base case is that the deteriorating growth outlook will lead to weaker business hiring intentions, thereby potentially limiting wage inflation in so called "second-round effects," and ultimately headline inflation as well. We expect the BoE to deliver a further 75 basis points (bps) worth of rate cuts this year, which is more than the current market expectation for cuts totaling 51 bps. The risk to our view is persistent upside inflation surprises fueled by tariffs and government spending, relative to BoE forecasts, which could limit further rate cuts.

- Chancellor of the Exchequer Rachel Reeves' Spring Statement, which restored fiscal headroom to £9.9 billion, leaves her with little room for error. Treasury's projected 2025/26 gross Gilt issuance of £299.2 billion is the peak over the 2029/30 forecast horizon, and will be skewed towards shorter-dated debt. We think Gilts will remain sensitive to any deterioration in public finances in the near term, but focus will likely shift to the BoE as markets await the Autumn Statement. Yields are at levels we view as compelling, and with potential interest rate cuts on the horizon, we see opportunities in adding to Gilts in the near term.

- Corporate bond yield compensation for interest rate risk is close to one-year peaks, thanks to higher Gilt yields and spreads. Company fundamentals have improved in Q4 2024, resulting in lower debt-to-earnings ratios and improved earnings coverage of interest expense, but challenges remain. Tepid growth will crimp corporate earnings, cash flows, and ultimately credit ratios, while a "gradual" BoE policy easing cycle will keep corporate refinancing costs higher for longer. We prefer allocating to higher-quality bonds with maturities of three to seven years in sectors such as Financials, Utilities (energy), and Communication Services, and favour issuers with global revenues that are less sensitive to slower UK growth.

REGIONAL FIXED INCOME PERSPECTIVES

Continenal Europe

- A sea change for Europe from the rise in coordinated defence spending coupled with Germany's €500 billion fiscal stimulus could boost economic growth. In addition, according to RBC Capital Markets, consumer spending will likely be spurred on by reduced savings, lower financing costs, and higher real incomes. RBC Capital Markets upgraded its GDP growth forecasts for the region to 1.4% y/y (from 1%) and 1.9% y/y (from 1.4%) in 2025 and 2026, respectively.

- The European Central Bank (ECB) stated that it cannot commit to a preset path for policy, "especially in current conditions of rising uncertainty," thus highlighting the difficulty in judging how much the European fiscal measures may offset the impact of current geopolitical tensions and reciprocal U.S. tariffs. While a rate cut is possible in April, we think a 25 basis point cut at the ECB's June meeting is more likely, as policymakers will then have more inflation data, updated staff forecasts, and more clarity on reciprocal tariffs.

- We think euro area sovereign bond yields are currently pricing in tariffs and the region's expansionary fiscal measures, but the risk of investor disappointment is high. While the fiscal optimism lasts, allocating to bonds to lock in yields at these levels in the near term looks compelling to us. In this volatile market, we are cautious about adding long-duration bonds issued by lower-rated nations to portfolios, as the risk of widening sovereign bond spreads remains high.

- European credit spreads have widened year to date, albeit still in rich territory on a one-year basis. Company fundamentals and strong demand will likely support corporate bond spreads in the near term, in our view, but sectors exposed to U.S. exports, such as Autos, Industrials, and Materials, could drag spreads wider from current levels. While high-yield bond valuations are less rich compared to those of investment-grade bonds, credit quality has deteriorated, and default rates have ticked higher and are close to five-year highs. We prefer investment-grade bonds over high-yield bonds, and maintain a cautious, selective approach. We prefer allocations along the steeper part of the yield curve in 3- to 7-year bonds.

Asia Pacific

- Asian bonds posted a total return of 2.7% in the first two months of the year, according to the Bloomberg Asia USD Investment Grade Bond Index. They outperformed their peers in other emerging market regions and the U.S., despite Asian credit spreads being at their tightest levels since the global financial crisis.

- Fund flows are turning more positive this year. Asian bond funds saw close to US$2.5 billion of inflows in January, compared to an average monthly inflow of US$1.1 billion over the past 10 years. We believe this is an important reason why Asian bond spreads have been relatively stable this year. A key driver that we think could continue to support Asian credit spreads is the change in rules for the Mainland-Hong Kong Mutual Recognition of Funds scheme, which increases the amount of money that Asian bond funds are allowed to raise in China.

- However, Asian economies remain vulnerable to U.S. tariff risk and we expect this to remain a near-term headwind for Asian credit. Different economies face varying levels of risk to economic growth. We prefer Japanese investment-grade bonds. We believe Japan is less exposed to growth risks due to robust domestic demand, which offsets the impact from weaker exports. We also believe Japanese investment-grade credit is much less sensitive to market volatility and is more defensive in terms of credit quality, and as a result should do well in an environment of rising growth risks.

Commodities

Matt Altro, CFA
Toronto, Canada
matt.altro@rbc.com

Commodity forecasts

Commodity	2025E	2026E
Oil (WTI $/bbl)	60.92	57.68
Natural gas ($/MMBtu)	3.30	3.50
Gold ($/oz)	2,844	3,111
Copper ($/lb)	4.10	4.50
Soybeans ($/bu)	10.06	10.50
Wheat ($/bu)	5.90	6.125

Source - RBC Capital Markets forecasts (oil, natural gas, gold, and copper), Bloomberg consensus forecasts (soybeans and wheat); data as of 3/17/25

Crude oil

Crude oil looks to be in a supply-driven market, pressuring prices lower globally. Recently announced OPEC+ supply additions have added to this price pressure alongside global economic uncertainty that is softening RBC Capital Markets' demand projections. RBC Capital Markets forecasts West Texas Intermediate crude at an average of US$60.92/barrel for 2025.

Natural gas

In the near term, warm weather forecasts in the U.S. have weakened natural gas prices. However, prices have risen over 100% in the last 12 months in response to increased power demand. RBC Capital Markets looks for some consolidation in U.S. natural gas prices with volatility remaining well above normal. It forecasts an average price of US$3.30/mmBtu in 2025.

Gold

Gold continues to attract "safe-haven" buyers amidst uncertainty regarding policies that could produce economic weakness and higher inflation. Per Bloomberg, U.S. recession probabilities have risen well above 30%, and with the risk of higher inflation due to tariffs and an uncertain Fed policy response, RBC Capital Markets forecasts the price to average US$2,844/oz for 2025.

Copper

Amidst seasonal restocking, the copper price has had a strong start to the year. China has rolled out stimulus packages to prop up its economy, driving demand. The key variable to this outlook is the possibility of broad-based economic weakness as trade/geopolitical headwinds produce more uncertainty. RBC Capital Markets forecasts an average price of US$4.10/lb for 2025.

Soybeans

The USDA's global soybean crush forecast has risen by 2.9 million metric tons to a record high, driven by demand for soybean meal and oil. Due to lower prices against substitutes, consumption forecasts for soybean meal and oil for the 2024/25 period are up by 1% and 2%, respectively. Bloomberg forecasts prices to average US$10.06/bu for 2025, in line with current futures pricing.

Wheat

For 2024/25, the USDA expects globally traded wheat volumes to post the largest year-over-year drop since 1985/86. Large importers like China, Turkey, and Pakistan are importing less due to sufficient domestic supplies. Large exporters like Russia and the EU have smaller crops this year. Bloomberg forecasts prices will average US$5.90/bu for 2025, higher than current futures pricing.

Chart source - RBC Wealth Management, Bloomberg; data range 10/12/23–3/17/25

Currencies

Nicolas Wong, CFA
Singapore
nicolas.wong@rbc.com

Currency forecasts

Currency pair	Current rate	Forecast June 2026	Change
Major currencies			
USD Index	104.27	99.46	-5%
CAD/USD	0.69	0.73	6%
USD/CAD	1.43	1.37	-4%
EUR/USD	1.07	1.12	5%
GBP/USD	1.29	1.29	0%
USD/CHF	0.88	0.90	2%
USD/JPY	149.43	130.0	-13%
AUD/USD	0.63	0.62	-2%
NZD/USD	0.57	0.55	-4%
EUR/JPY	161.21	146.0	-9%
EUR/GBP	0.84	0.87	3%
EUR/CHF	0.95	1.01	6%
Emerging currencies			
USD/CNY	7.27	7.40	2%
USD/SGD	1.34	1.35	1%

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

Source - RBC Capital Markets forecasts, Bloomberg

U.S. dollar: Market sentiment turns bearish

The U.S. Dollar Index (DXY) fell by about 4% in Q1 as economic data showed a slowdown in the U.S. economy. Investors shifted focus from inflation risks to recession risks, and priced in more interest rate cuts from the Federal Reserve than they had previously. RBC Capital Markets analysts see a higher dollar in Q2 due to the likely implementation of reciprocal tariffs in April, but with the risk of recession rising materially later in 2025, they expect modest USD weakness in H2. However, they note that a re-emergence of inflation would require upward revisions for the dollar.

Euro: Supported by German fiscal spending

Germany's plans for fiscal expansion along with improving eurozone economic data have made the euro one of the top performers among G-10 currencies in 2025. However, RBC Capital Markets analysts think the euro area will likely be hit by U.S. tariffs in April and see the EUR/USD pair lower at 1.05 in Q2, a higher trough than the 1.02 they previously pencilled in. They then expect a modest EUR/USD rise throughout 2025.

Canadian dollar: Weighed down by Trump tariffs

The Canadian dollar was the worst-performing G-10 currency in Q1 amid Trump's tariffs targeting Canada. RBC Capital Markets has left the USD/CAD forecast unchanged at 1.45 for Q2 and will reassess after the April deadline for reciprocal tariffs, with a base case of the pair trading in a 1.40–1.47 range in the coming months. On the political front, attention turns to the timing of the federal election, where more business-friendly policies could lend support to the loonie in the long run.

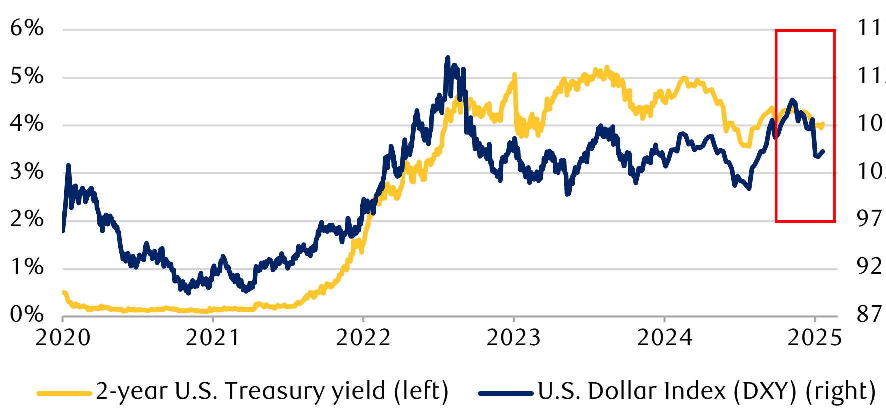
British pound: Low risk from reciprocal tariffs

GBP/USD rallied to 1.30 from 1.21 in Q1, helped by the UK's perceived safety from U.S. tariff risks. The absence of a dovish pivot from the Bank of England has also kept the pound as a high yielder in the G-10, as the central bank waits for evidence of the impact of the most recent UK budget. RBC Capital Markets has a flat profile of around 1.28 on the GBP/USD, but sees the pound underperforming the euro in 2025.

Japanese yen: Further gains on BoJ hikes

USD/JPY fell sharply in Q1, with RBC Capital Markets analysts expecting further weakness in the pair as Japanese investors continue to add hedges from their overseas bond holdings (by selling USD and buying JPY on a forward basis), with the cost of hedging falling as the interest rate gap between the U.S. and Japan narrows. They look for a short-term bounce to 149 in Q2 on the back of U.S. tariff implementation, followed by a drift to 140 towards year's end.

The U.S. Dollar Index tracked 2-year Treasury yields lower in Q1 2025 in the wake of softer-than-expected economic data

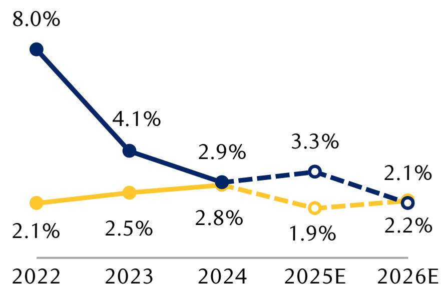


Source - Bloomberg, RBC Wealth Management, data through 3/25/25

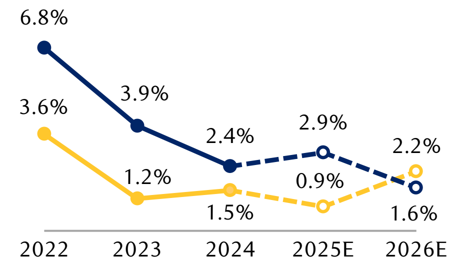
KEY

Forecasts

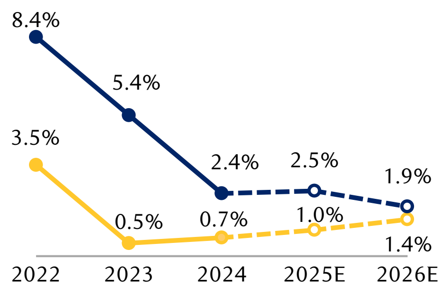
United States



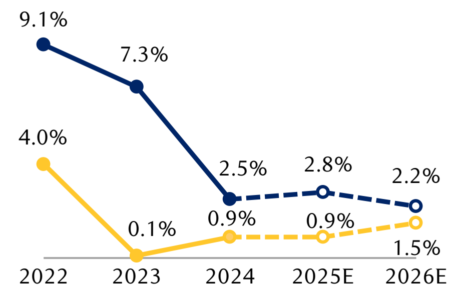
Canada



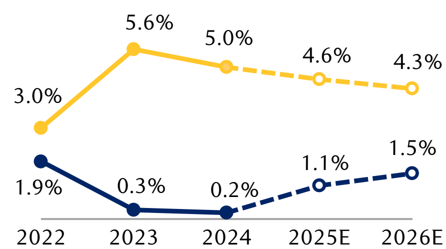
Eurozone



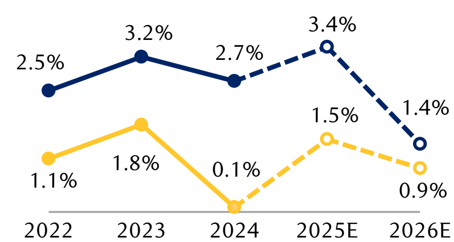
United Kingdom



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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Alan Robinson – Senior Portfolio Advisor, 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

David Storm, CFA, CAIA – Chief Investment Officer, British Isles & Asia, RBC Europe Limited

Yuh Harn Tan – Head of Discretionary Portfolio Management & UHNW Solutions, Royal Bank of Canada, Singapore Branch

Joseph Wu, CFA – Portfolio Manager, Multi-Asset Strategy, RBC Dominion Securities Inc.

Additional Global Insight contributors

Matt Altro, CFA – Portfolio Advisor, RBC Wealth Management Portfolio Advisory Group – Equities, RBC Dominion Securities Inc.

Jasmine Duan – Senior Investment Strategist, Royal Bank of Canada, Hong Kong Branch

Nicholas Gwee, CFA – Portfolio Strategist, Royal Bank of Canada, Singapore Branch

Shawn Sim – Head of Fixed Income, Royal Bank of Canada, Singapore Branch

Nicolas Wong, CFA – Head of FX, Asia, Royal Bank of Canada, Singapore Branch

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Sell [Underperform]	44	2.96	5	11.36

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