GLOBAL Insight

May 2025

Perspectives from the Global Portfolio Advisory Committee

Imbalancing act

Running up debts to buy foreign goods is unsustainable in the long term. Identifying the problem is simple, but we see no easy or quick escape for the U.S. from the imbalances built up over the last four decades.

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Our 2025 Midyear Outlook

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GLOBAL
Insight

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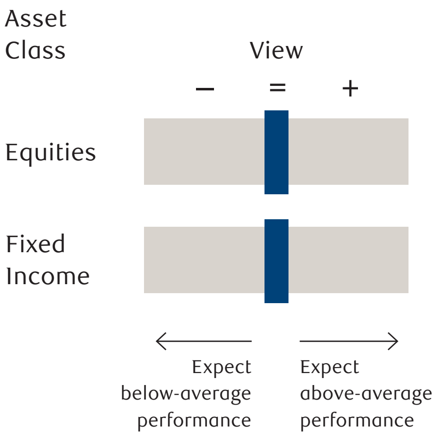

(+/=/–) represents the Global Portfolio Advisory Committee's (GPAC) view over a 12-month investment time horizon.

+ 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

- Equity markets worldwide continue to grapple with ultrahigh levels of U.S. tariff policy uncertainty and related economic and corporate profit headwinds. The Trump administration has signaled that broad frameworks of trade agreements with some countries could be forthcoming soon. Regardless, we think equity markets will remain on edge until there is at least some clarity about tariff policy with America's largest trading partners—the EU, China, Canada, and Mexico, which collectively represent 60% of U.S. imports.
- At this stage, the U.S. economic environment is looking mildly "stagflationary" instead of outright recessionary. RBC Economics forecasts 2025 U.S. GDP growth could end up at just 1%, well short of the 2.7% average of the past three years and a level that we would characterize as "stall speed." It expects core consumer inflation (excluding food and energy) to jump to 4.3% by Q3 from 2.8% in March. We doubt this is fully priced into consensus earnings estimates.
- We think the ultrahigh levels of uncertainty argue for holding equities in portfolios up to but not beyond a Market Weight level.

Fixed income

- Global bond market volatility, which has been a fixture this year, continued into April as uncertainty and shifting global dynamics upend the status quo. Despite the volatility, the direction of travel has generally been toward lower yields as rising economic growth concerns are outweighing renewed inflationary pressures on the back of tariffs and trade wars.
- We remain Overweight U.S. Treasuries paired with an Underweight for global developed market bonds. Slowing growth in the U.S. despite an anticipated uptick in inflation will likely mean a resumption of rate cuts from the Federal Reserve this year, in our view. Inflation remains less of a concern for European Central Bank (ECB) policymakers with the focus on growth, and the ECB is likely to cut twice more this year.
- We reiterate our Market Weight stance on U.S. fixed income with yields remaining above multi-decade averages. Credit valuations are still too rich globally, in our view, amid increasing growth risks, which leads us to continue favoring sovereign bonds over corporate bonds.

MONTHLY

Focus

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Imbalancing act

Having one country—the U.S.—run up debts acting as the buyer of last resort for foreign country production is not sustainable in the long term. Identifying the problem is easier than fixing it, however, and we see no easy escape for the U.S. from the trade imbalances created over the last four decades. We believe that a quick fix, go-it-alone approach is likely to be a difficult pill for markets and economies to swallow.

Key points

- **Reducing trade imbalances is a worthwhile goal, but we think reciprocal tariffs are inadequate for the task.**
- **If the Trump administration wants a quick fix, it can look to currency markets, debt restrictions, or more import taxes, but all of these have high costs.**
- **A unilateral quick fix is unlikely to be a net short-term positive for the U.S. or global economies.**

We'd previously been of the idea that tariffs were an effective way for the U.S. to exploit foreign countries' reliance on American consumers. In short, a negotiating lever.

While we think that the Trump administration ultimately has to adopt that approach, we don't believe the so-called reciprocal tariffs announced in the Rose Garden can reasonably be viewed through that lens. The number of countries, the lack of U.S. strategic interests in some very high-tariff countries, and the means of calculating the tax level all indicate to us that the White House's goals were much broader: a profound restructuring of global production and trade to eliminate or significantly reduce the U.S. trade deficit.

The trillion-dollar question is whether that goal still exists. The consensus view—which we think has merit—is that the administration's 90-day pause on most of its single-country tariffs will be extended indefinitely. The benign interpretation is that the administration is likewise shelving its aspirations to transform the world's economic links.

The more troubling prospect, in our view, is that the White House plans to follow through on its public commitments to radically and quickly reduce U.S. trade deficits. If those plans materialize, we think investors should be prepared for additional market and economic volatility. Trying to fix imbalances created over four decades in four years or less is not going to be without collateral damage, in our opinion.

Wrong tool for the right job

It's important to be clear at the outset that there is a problem with global trade patterns. Having one country run up debts to be the buyer of last resort for foreign country production is not sustainable in the long term.

IMBALANCING ACT

No matter how we describe it—an inevitable consequence of the U.S.'s role as reserve currency provider, exploitation by foreign countries, or Adam Smith's invisible hand in action—we believe there is a large and growing risk when debt-funded demand is the prop on which we build the world.

On their face, tariffs could kick-start a realignment. The problem is credibility. To work, tariffs must be in place for years and likely decades. It's simple math. Rebuilding U.S. manufacturing takes factories, and factories take years to build. An investor today needs to know that the tariffs that make U.S. domestic production viable will last long enough to generate a decent return on the investment. That's not a one or two quarter time horizon.

From our vantage point, the import taxes rolled out in April had a foundational flaw to bring manufacturing back. They were implemented through an executive order based on an emergency declaration. Legally, they can be turned off in an instant by the courts, by Congress, or by the president. An investor cannot realistically project the attitude of the judicial, legislative, and executive branches for decades.

The administration's pivot away from reciprocal tariffs was, we believe, a tacit recognition that the tool was inadequate for the task. In our view, which is shared by most published forecasts that we have seen, the administration is now looking to tariffs to provide revenue and as a negotiating lever against foreign countries.

Be careful what you wish for

If, however, the Trump team's goal of reducing the trade deficit and boosting domestic manufacturing in a short time frame survives the tariff pivot, we think it's clear that there would be real costs to success:

- **Lower efficiency:** Trade creates gains by letting economies focus on the areas where they are relatively most efficient—the greatest output for the least input. Interfering with that dynamic is going to be less productive. That's not a deal killer—efficient systems are some of the most fragile and a robust system often has built-in inefficiencies—but it is part of the tradeoff.

- **Living less well:** The U.S. status quo is a short-term macro positive—the country gets to consume more today and promise payment tomorrow. Paying off debts means consuming less than we could. That's unlikely to be fun or popular.

- **Higher prices:** U.S. labor costs more than overseas labor. If the U.S. is going to start building things here with higher-cost labor, it either needs to be more productive or producers need to charge more. We believe it's bordering on a fairy tale to think the U.S. can achieve the necessary productivity gains to achieve fully balanced trade at current prices, so higher prices are one likely counterpart of "success."

In short, we believe lower trade balances are likely to end up with slower economic and corporate earnings growth, slower potential growth, and higher prices.

Where to next?

If the administration wants to act unilaterally to quickly reduce the U.S. trade deficit, we think it has few options and no good ones.

Currencies

Weakening the U.S. dollar would help reduce the trade deficit by making U.S. exports cheaper overseas and increasing the dollar cost of foreign goods. This works on the trade deficit for a while, but it comes with some self-defeating baggage.

The issue is inflation. A weak dollar is just another way of saying Americans get less for their money, a pretty effective way of describing inflation. The self-defeating part of currency weakening is that inflation tends to trigger higher interest rates from the U.S. Federal Reserve that—in turn—push up the dollar's value.

Central banks can try some fancy footwork to avoid this outcome, but the track record is weak. In realistic terms, with global cooperation, intervening to weaken the dollar could reduce—but not solve—the U.S. trade deficit, and likely only for a short time. Without cooperation, we doubt that it can produce even that temporary respite.

Debt

At the end of the day, when the U.S. buys more stuff than it sells, foreigners are left with excess dollars that they use to buy U.S. assets like Treasury bonds. Economists call the former the current account and the latter the capital account. Although these accounts have to balance, it's not always clear which one drives the bus.

The White House points to currency manipulation by China as a cause of trade imbalances. China might well say that it's the insatiable U.S. appetite to borrow that keeps foreign countries from importing more U.S. cars—a dollar invested in Treasuries is a dollar that can't be spent on U.S. goods. Whatever explanation we choose, there's no denying that there's a link between access to U.S. assets and the ability to run a persistent trade surplus with America.

A roundabout way of reducing trade deficits, therefore, is to make it more expensive for foreign countries to purchase U.S. assets like Treasury bonds. Essentially, don't add costs to the goods being traded, but add costs to the surplus that other countries generate. This may seem like a simple and easy fix that automatically ramps up as countries run bigger trade surpluses, but it's a horrifically bad idea—in our view—in the U.S. context.

To start with, the Trump administration just asked the House of Representatives to add $5 trillion to the roughly $28 trillion that the nation currently owes. Throwing up roadblocks to lenders is just silly.

More importantly, deep and liquid debt markets are a huge economic and geopolitical advantage. For decades, the UK punched above its weight class in the European balance of power because the City of London's domination of finance gave the British the ability to raise military funding quickly and cheaply. The U.S. currently enjoys a similar advantage and ceding it would be illogical, in our view.

Finally, weaponizing debt would be crossing a line, potentially opening the door to retaliatory selling by existing creditors. When an economy is built on borrowing, bond brinkmanship is risky for creditors and debtors alike.

Tariff redux

Officially, the U.S. has not abandoned tariffs as a means of reducing the trade deficit—quite the contrary, the administration's statements and actions are both consistent with the idea that trade balance remains at the core of its tariff strategy.

A hardline tariff approach can take many forms. Extremely harsh negotiating positions, for instance. Or widespread use of sector tariffs instead of individual country tariffs—even if applied at a 25 percent level, the broader application and greater difficulty of evasion can give sector tariffs a big bite. Finally, the administration could let large chunks of the reciprocal tariffs resume after the current pause expires. Any of these techniques—alone or in combination—would likely lead to more of the "yippy" behavior that led to tariffs being paused in the first place. As a result, we think a tariff relaunch is unlikely but should not be ruled out.

End goals, own goals, and shared goals

The consistent theme of these approaches is that they are likely to be both ineffectual and costly.

While we can see the desirability for an administration to leave its mark through quick and impactful action, we believe the economic and market consequences of pulling any of these levers are likely to be dramatic and negative.

Ultimately, we believe the trade balance is not something that can be undone by a single country and certainly not by a single individual. There are profound questions of timing, burden-sharing, and international balance of power. At its best, the administration's tariff-led attempt to confront trade imbalances could spark the type of long-term, multilateral dialogue that's needed to build a domestic and international consensus on trade reform. At its worst, however, a go-it-alone approach is likely to be a difficult pill for markets and economies to swallow.

GLOBAL
Equity

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Either/or ...

After its steep seven-week drop in February and March, the S&P 500 spent April regaining some of its composure and about two-thirds of the lost ground. The same was more or less the case for all the developed-economy benchmark indexes. Now, markets look to be at a crossroads, with plausible paths in either direction.

By some measures, the S&P 500 is still in the early days of the current rally. Another few weeks of upside might bring the index closer to the February high-water mark, perhaps even to a new all-time high. More market upside would require a catalyst, in our view. A Ukraine truce would be helpful; so too would be a meaningful drop in core inflation, enough to put a resumption of Fed rate cutting back on the table and with it some further retreat in bond yields.

Waiting for a deal

The one catalyst that could convincingly revive investor optimism and put the bulls back in control would be some significant improvement on the trade front: perhaps a deal between the U.S. and a noteworthy trading partner that significantly lowers the tariff burden as well as the scope of goods affected, raising the prospect that similar deals with other trading partners might reasonably be expected to follow. (Commerce Secretary Howard Lutnick has indicated just such a deal has been negotiated, awaiting only ratification by the partner's government.)

The air needs clearing

But until frameworks of trade deals are broadly agreed to between the U.S. and its largest trading partners—the EU, China, Canada, and Mexico, which together represent about 60% of imports—skepticism about tariff risks could hang over the market.

Equity views

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

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

Which brings us to the potential for a negative market outcome. If no convincing "pathway" deal materialises on the trade front within a couple of months, consumers and businesses would be left "on hold," fearing the worst and adjusting spending plans accordingly. It would also leave the Fed where it is today, between a rock and a hard place, leery of cutting rates ahead of an inflation shock it knows will be coming. Continuing uncertainty could leave the U.S. economy edging toward a more profound slowdown—possibly a recession.

RBC Capital Markets, LLC's Head of U.S. Equity Strategy Lori Calvasina argues that the S&P 500, even at its worst point—the April 7 intraday low—was not pricing in a recession (see table). In other words, if a U.S. recession were on the way, so too would be additional downside for the equity market.

But a U.S. recession is far from a foregone conclusion, in our view. Since the Trump administration says it is negotiating dozens of bilateral trade deals, we believe the possibility of one or more consequential ones being struck is rising and shouldn't be discounted. So too is the prospect that the equity market could prove stronger than currently expected.

GLOBAL EQUITY

Breadth votes for more upside

At least one measure of market breadth has recently cast an important vote in favour of more equity market upside ahead. The so-called "advance-decline line" keeps track of the proportion of stocks rising in price versus those declining on a daily basis. All through the latest pullback, the advance-decline line for the S&P 500 has performed better than the index itself, holding its ground to a much greater degree.

The A-D line has just set a new cycle high, but the S&P 500, while well up off its recent low, is still about 9% below its February peak. New highs in breadth have often been accompanied or followed fairly quickly by new highs in the index.

Set against this potential technical strength, there are some worrying signs on the earnings front. In addition to the growing number of CEOs who admit to being confounded by the question of what will be the eventual impact of tariffs on their businesses, we now have analysts backing away as well—less than one-third of S&P 500 earnings estimate revisions have been to the upside.

The economy will decide

Getting the economy right means getting the U.S. consumer (about 70% of GDP) right. Despite consumers' expectations for the future recently sagging to a 13-year low, U.S. consumer spending remained positive through Q1, possibly thanks to pre-tariff car buying. To persuade the consumer to pare back their spending enough to deliver a recession would require a marked deterioration in the employment outlook, which so far is nowhere in evidence but could arrive quickly as tariffs bite in the coming months. Or not.

We are leaving our setting unchanged for now: cautious, watchful, but invested. Our focus remains on resilient businesses with the least to lose should a recession materialise.

The four tiers of fear in modern U.S. equity markets

	What a peak-to-trough drawdown looks like historically	Equivalent downside levels to keep in mind today
Tier 1: Garden-variety pullback *Occurs several times in a bull market*	5%–10% drawdown	Roughly 5,500 The first stopping point in the correction was at 5,504 on March 13, followed by a modest bounce over seven trading days
Tier 2: Growth scare *Investors worry intensely about a crisis or recession that fails to materialise*	14%–20% drawdown	Roughly 4,900–5,300 The low trade for the index was 4,835 on April 7; it has since recovered about two-thirds of the losses since the Feb. 19 all-time peak
Tier 3: Recession	Median drawdown of 27% Average drawdown of 32%	Roughly 4,200–4,500
Tier 4: Major crisis	Drawdown of roughly 50% or more as a rule of thumb	Roughly 3,100

Source - RBC Wealth Management, RBC Capital Markets U.S. Equity Strategy

GLOBAL

Fixed income

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Seeing through the fog

It's nearly impossible to look back at everything that transpired in April and come away with anything approaching a reasonable scenario for what might come next, but markets and investors must contend with what comes next, regardless.

If there's one thing that is at least reasonably clear to us, it's that inflationary pressures are going to be higher and growth slower—and the bulk of it will likely be felt by the U.S.

Though tariffs have been delayed, once again, it only means that uncertainty will linger longer. Even if the worst case for tariffs appears to be off the table, average tariff rates look set to remain at the highest levels seen in decades.

In April, RBC Capital Markets raised its 2025 CPI forecast to 3.2% y/y while lowering real economic growth (adjusted for inflation) to just 1.0%. As the chart shows, in its modeling inflation is only seen accelerating materially in the U.S., though growth in all regions is expected to be slower than previously estimated.

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

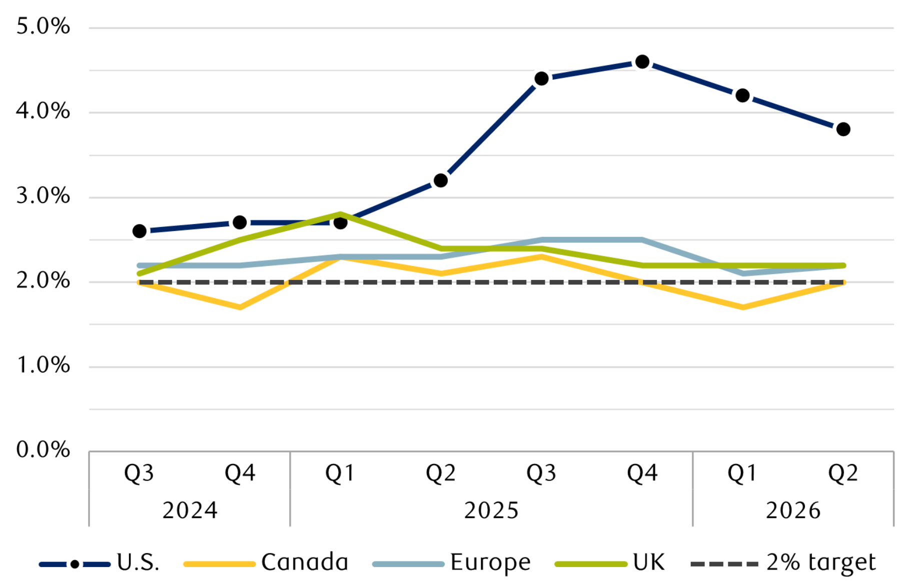
+ Overweight; = Market Weight; – Underweight
Source - RBC Wealth Management

An environment of higher inflation and slower growth is not an ideal one for bond investors—and certainly less so for central bankers—so what now?

In the U.S., at the end of the day we still expect slower growth concerns will outweigh higher inflation fears in the eyes of the markets. The benchmark 10-year Treasury bond traded as high as 4.60% in April, a level which—along with other market-stress points—caused the administration to delay tariffs, in our view. As markets stabilized in late April, we are already seeing signs

The U.S. may be alone in navigating another inflationary wave

RBC Capital Markets inflation forecasts



Source - RBC Wealth Management, RBC Capital Markets forecasts for Q2 2025 and later as of April 2025; based on headline consumer price indexes

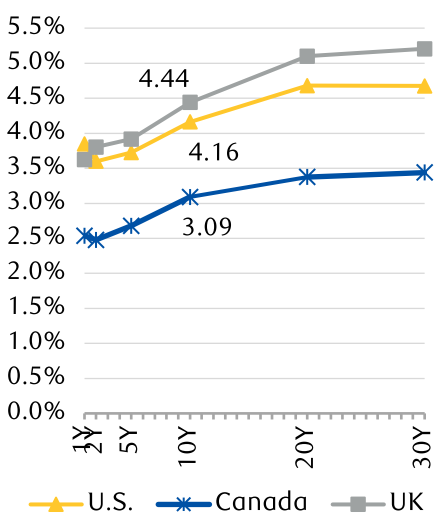
GLOBAL FIXED INCOME

that growth concerns are returning to the driver's seat with the 10-year yield fading toward just 4.15%; we now see it falling to 3.75% by the end of the year as we think the Fed is likely to cut interest rates three times beginning in September.

With global inflation less of an issue amid elevated growth fears, the European Central Bank set the tone by not only cutting rates again in April but also by signaling more are likely on the way. RBC Capital Markets now expects two more 25 basis point rate cuts this year to a terminal level of 1.75%. After also cutting in April, the Bank of Canada is likely to cut once more in June, in our view, before pausing and turning to fiscal tools to support the economy.

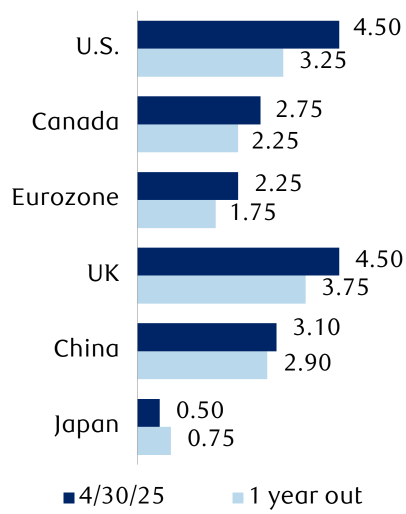
As we have maintained throughout this year, tariffs and trade wars are bad for inflation but even worse for growth, with the latter likely to ultimately mean lower interest rates.

Sovereign yield curves



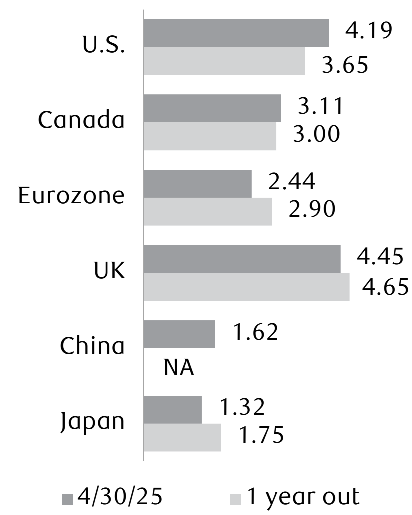
Source - Bloomberg; data through 4/30/25

Central bank rates (%)



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

10-year rates (%)

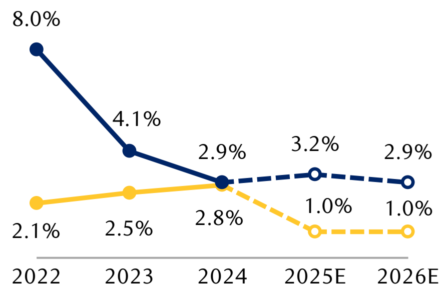


Note: Eurozone utilizes German Bunds.
Source - RBC Investment Strategy Committee, Global Portfolio Advisory Committee, RBC Global Asset Management

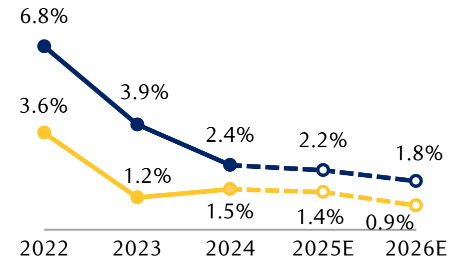
KEY

Forecasts

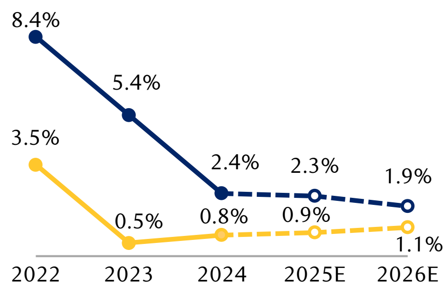
United States



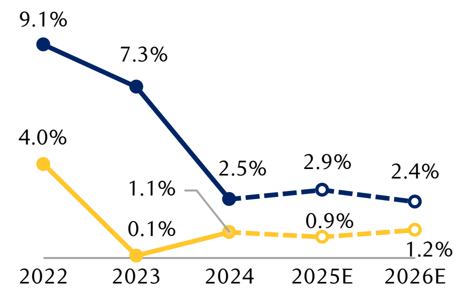
Canada



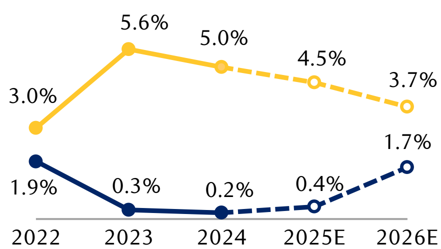
Eurozone



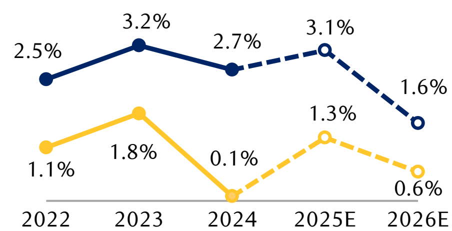
United Kingdom



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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Distribution of ratings – RBC Capital Markets Equity Research
As of March 31, 2025

			Investment Banking Services Provided During Past 12 Months	
Rating	Count	Percent	Count	Percent
Buy [Outperform]	878	59.12	285	32.46
Hold [Sector Perform]	563	37.91	146	25.93
Sell [Underperform]	44	2.96	5	11.36

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