GLOBAL
Insight

2025 Midyear Outlook

RBC Wealth Management

Perspectives from the Global Portfolio Advisory Committee

June 2025

Curves ahead

Major markets and economies will continue to navigate around Washington and Fed policies. On the road ahead, there are at least two new factors to consider.

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For important and required non-U.S. analyst disclosures, see page 34.

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Insight

2025 Midyear Outlook

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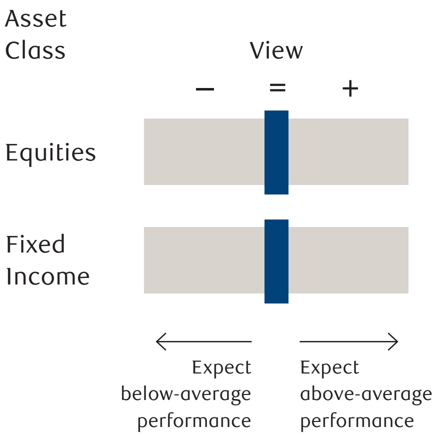

(+/=/–) represents the Global Portfolio Advisory Committee's (GPAC) view over a 12-month investment time horizon.

+ 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

- A casual observer looking at the S&P 500 Index near its all-time high would be forgiven for believing that it was "business as usual" for corporate America. To be fair, after the White House pulled back from ultra-high tariff rates, the U.S. economy is proving resilient for now with few signs of inflation or unemployment picking up. But those may well start to appear in the second half of the year if the remaining tariffs start to bite, impacting business and consumer decisions.
- Geopolitical risks have rushed back to the fore following military escalation in the Middle East. Should crude oil prices continue to rise, threatening to pressure the U.S. and global economies, RBC Capital Markets anticipates the Trump administration will ask OPEC to lift oil production. However, if the conflict becomes protracted or widens, the risks would expand.
- Overall, we think the current situation warrants a watchful portfolio investment approach and no more than a Market Weight in global and U.S. equities. We believe other regions, with valuations trading at a discount to U.S. equities, provide attractive opportunities to diversify portfolios.

Fixed income

- Global bond market volatility has been a fixture of the year thus far 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. However, rising government debt levels leave us more cautious on longer-dated sovereign bonds, and more neutral on interest rate risk exposure.
- 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. Conversely, many global central banks such as the European Central Bank and the Bank of Canada—which have proceeded steadily with rate cuts—are now likely at the end of such cutting cycles.
- 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.

MIDYEAR
Focus

A world of opportunities?

A dramatic shift in the appetite for equity and fixed income securities issued outside of North America has emerged in 2025. Meanwhile, the realignment of international trade norms triggered by the Trump administration's tariff policies has upended the performance profiles of global stocks, with some investors wondering if the lengthy period of outperformance by U.S. stocks relative to their international peers over the last decade may be at a turning point. We examine the causes of this pivot, what they might mean for international stocks over the foreseeable future, and how investors may want to position portfolios.

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Key points

- **Tariff upheaval has triggered a renewed interest in global equity diversification as a hedge against volatility in individual markets.**
- **This comes as the trade-weighted Dollar Index is under pressure due to concerns over the sustainability of U.S. fiscal deficits.**
- **While we don't think the age of "U.S. exceptionalism" is over, we do think the recent dramatic shifts in U.S. policy provide a catalyst to reassess geographic exposures in a global portfolio.**

Tariff upheaval triggers a rally in overseas stocks

The first five months of 2025 have seen a seismic shift in global trade norms as U.S. President Donald Trump seeks to use tariff threats as a tool to achieve his policy goals on the international stage, and as a way to raise revenue.

The initial new tariff schedule announced on April 2 effectively raised the average tariff charged by the U.S. to 19 percent from three percent, with wide variations across trading partners. The most punitive tariffs are on hold pending trade negotiations, and we believe the complexity of inking lasting trade deals suggests that many of these tariffs will quietly go away. But the uncertainty generated by shifting trade rules is likely to impact investment patterns globally over the long term.

The U.S. economy is the most self-contained of all the world's developed economies. On the surface, this suggests new policies that stymie trade should impact the U.S. less than its trading partners; however, the tariff upheaval has revealed how deeply integrated U.S. companies are in the global economy and supply chains.

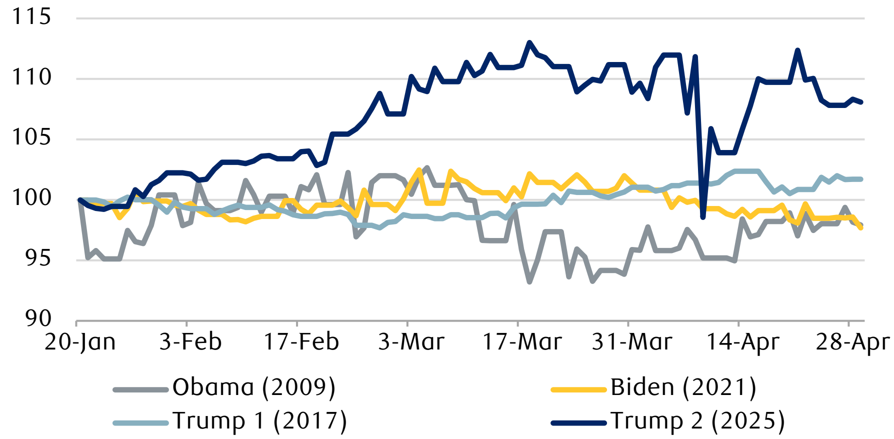
While all global trading blocs now face higher tariffs, during the first 100 days of Trump's second term, investors in European stocks have fared better than those investing in U.S. stocks. This is atypical for new administrations (see chart on following page) and is different from Trump's first term, which had more in common with those of the presidents who bookended it, at least in terms of relative equity performance.

Alan Robinson co-manages the firm's Guided Portfolio of international stocks that trade on U.S. exchanges. He serves on RBC Wealth Management's Global Portfolio Advisory Committee, where he is responsible for currency strategy and market commentary. With more than three decades of experience in financial markets, Alan has worked in London and Hong Kong, where he traded currency and credit derivatives.

A WORLD OF OPPORTUNITIES?

New administration policies have favored European stocks

STOXX Europe 600 vs. S&P 500 in first 100 days of presidential terms



Source - RBC Wealth Management, FactSet; daily index data in local currency, normalized, with first day of term = 100

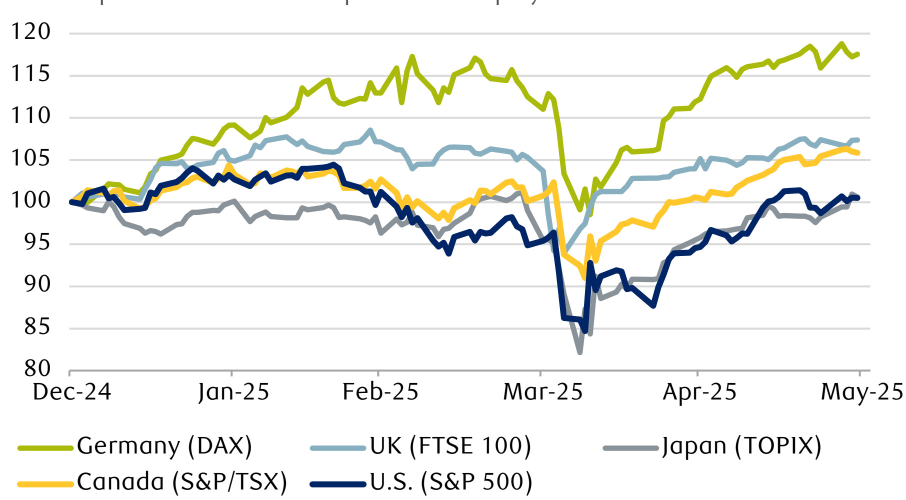
Why did international stocks outperform?

One of the common narratives from market pundits analyzing this period of international stock outperformance concerned "the end of U.S. exceptionalism." This posited that no economy would emerge unscathed from the trade upheaval and that the global stability and low prices that had fueled U.S. consumer spending and driven outsized U.S. corporate profit growth were at an end. This was accompanied by concerns that the reliability of U.S. institutions and legal norms was at risk.

We would push back against this narrative. While some overseas institutions repatriated securities held in the U.S., there was no wholesale flight, in our view. Instead, the new, more uncertain paradigm encouraged investors to rebalance portfolios that had long been overweight U.S. stocks as "the only game in town." The tariff upheaval was the catalyst to put money to work in foreign equities that had long traded at a significant discount to U.S. stocks.

International equities have produced broad-based gains versus the U.S.

Relative performance of developed-market equity indexes



Source - RBC Wealth Management, FactSet; daily data through 5/30/25, normalized with 12/31/24 = 100

A WORLD OF OPPORTUNITIES?

The tariff storm shook the governments of several of the U.S.'s trading partners out of their policy complacency. Many countries turned to their fiscal stimulus playbook, further helping sentiment toward international stocks. Germany, in particular, abandoned its long-held fiscal deficit limit to invest heavily in defense and infrastructure.

There was a clear pattern of outperformance by overseas stock markets, based on the extent of fiscal and monetary stimulus, with the more cautious Japanese government pouring cold water on the hopes of a looser monetary policy, which limited the gains in Japanese stocks (see chart on previous page).

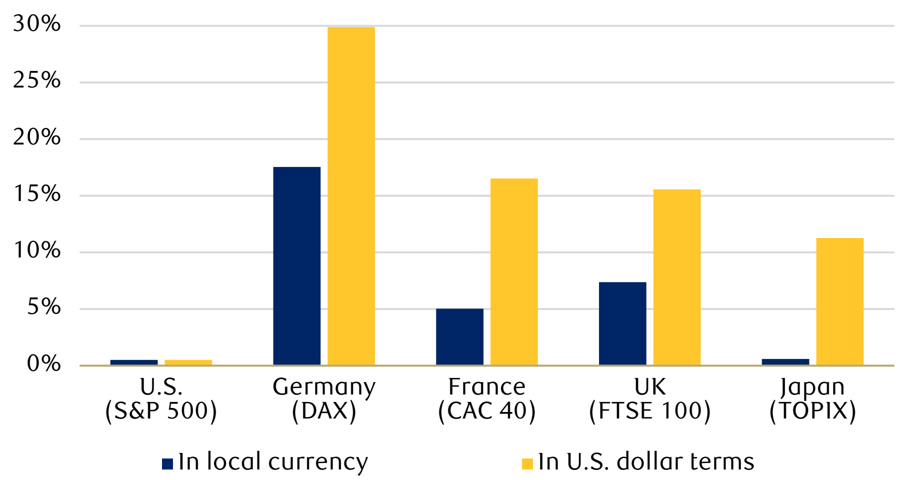
The weaker dollar boosts foreign currency assets further

While foreign investors celebrated gains in their domestic stock markets, U.S.-based investors with overseas exposure did even better relative to their home market. This was because the value of the dollar declined against major currencies, and this inflated the value of overseas stocks denominated in appreciating foreign currencies.

For example, the German DAX Index gained 17 percent over the five months ending May 2025, while the S&P 500 Index eked out a one percent gain. But the 10 percent gain in the value of the euro against the dollar over that period served to almost double the return of the German equity market, from the perspective of dollar-based investors, with UK and Japanese stocks enjoying a similar tailwind to dollar-denominated returns (see chart below).

International stock returns have been even better in U.S. dollar terms

2025 year-to-date equity market returns



Source - RBC Wealth Management, FactSet; data through 5/30/25

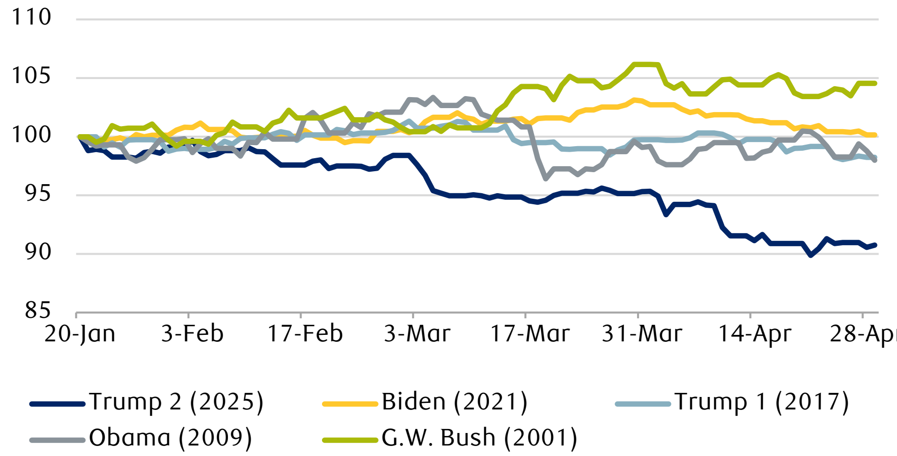
Part of the decline in the value of the dollar was attributed to statements from Trump suggesting he'd be happy with a declining dollar, as this would make U.S. exports more competitive.

Some of these statements were walked back by his cabinet, but the global rebalancing discussed above, together with a historically overvalued dollar leading into Trump's second term, kept pressure on the greenback. This

A WORLD OF OPPORTUNITIES?

Trade rhetoric pressures the U.S. dollar

U.S. dollar performance in first 100 days of presidential terms



Source - RBC Wealth Management, FactSet; daily data, normalized with first day of term = 100

period of dollar weakness stands in contrast to the relative stability of the currency during the first few months of previous administrations (see chart above).

The weakness of the dollar so far in 2025, while significant, pales in comparison to the currency's gains since its cycle low in 2008 (see chart below). The trade-weighted U.S. Dollar Index, or DXY, gained 62 percent from March 2008 to its peak in 2022. The nine percent decline in the DXY over the first five months of 2025 has put a dent in that, but the currency is still overvalued on a purchasing power parity basis by as much as 12 percent against the euro, 14 percent against the Canadian dollar, and a whopping 70 percent against the Japanese yen as of the end of Q1 2025.

The dollar's multiyear bull trend is looking long in the tooth

U.S. Dollar Index (DXY)

Source - RBC Wealth Management, FactSet; data through 5/30/25

From our vantage point, if the dollar starts on a new bear cycle, overseas assets will start to look more appealing for U.S. investors. And investors outside of the U.S. will no longer have the benefit of a strong dollar acting as a tailwind to the returns of their U.S. assets. This will likely result in further rebalancing away from the U.S. as the dollar declines, and foreign investors' sales of U.S. assets will weaken the dollar further in a gradual feedback loop.

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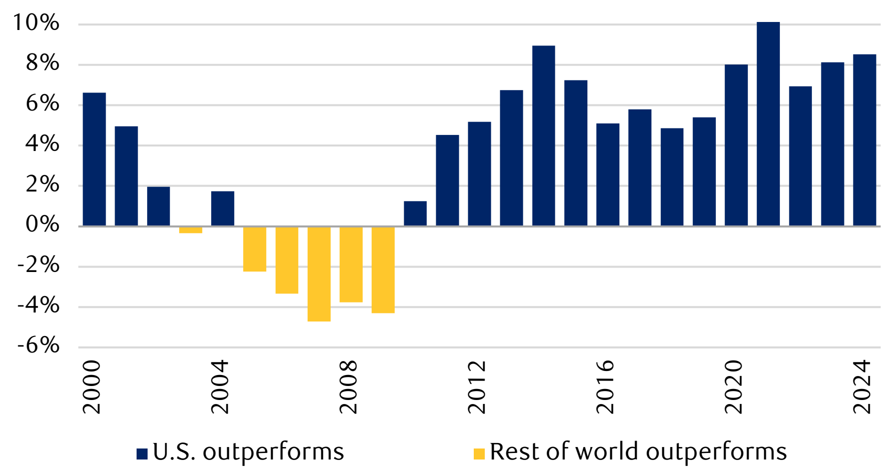
Changes in export patterns caused by higher tariffs will further complicate the issue, in our opinion. If overseas exporters sell fewer goods into the U.S., they will receive fewer dollars in return from U.S. consumers and businesses. These dollars would have likely been invested back into U.S. stocks and bonds, so a decline in trade may reduce the fuel needed to support U.S. asset markets.

No reason for U.S. investors to stray from home base ... until now?

The rally in international stocks relative to their U.S. peers this year has gained a lot of attention. But their recent outperformance is eclipsed by the consistent outperformance of U.S. stocks since 2010. Over that time frame, U.S. stocks' annual returns beat those of their peers in 13 of the 15 years through 2024, and using a five-year rolling return metric favored by long-term investors, the U.S. has outperformed consistently over that period (see chart below).

Will U.S. stocks ever stumble?

Annualized performance difference of five-year rolling returns



U.S. stocks represented by the S&P 500 Index, rest of world by the MSCI All Country World ex USA Index.

Source - RBC Wealth Management, FactSet

Most of this historical outperformance has coincided with the dollar bull market discussed above. If the dollar cycle switches to a bear market similar to the 1999–2009 period, we believe international investors' appetite for non-U.S. stocks will resurface, as the MSCI All Country World Index beat the S&P 500 in seven out of those 11 years.

U.S. exceptionalism under the microscope

There are usually wide disparities between the composition of equity markets of different nations. Larger economies tend to have larger stock markets, when measured by market capitalization. But the relationship is not linear, with the U.S. as an extreme outlier. In fact, the U.S. economy accounts for about 20 percent of the total global economy, but the U.S. stock market represents 65 percent of global stock market capitalization.

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Why is there such an apparent discrepancy? One element is the relative valuation of stocks. U.S. stocks typically trade at higher price-to-earnings (P/E) valuations than their developed-market peers for well-understood reasons.

One is the composition of stocks across different sectors. The U.S. has a higher proportion of technology stocks than other countries. Technology companies tend to grow revenues and profits more quickly than companies in other sectors, so their stocks are afforded a higher valuation. The U.S. also has a lower proportion of Materials sector and commodity stocks relative to other developed markets. This can be a drag on the U.S. market's relative performance when value-themed stocks outperform, given these stocks are over-represented in these sectors. But their scarcity in the U.S. indexes adds to the average valuation multiple.

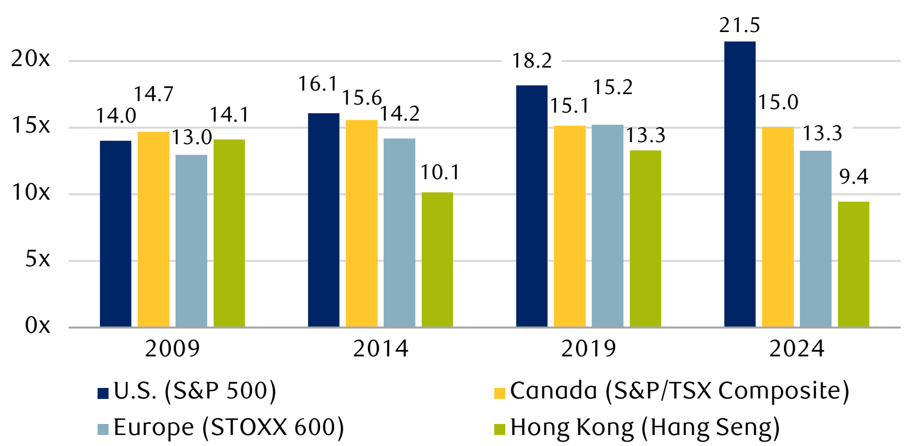
Another reason is the regulatory and taxation environment, which tends to be more friendly to companies in the U.S. The more relaxed regulatory environment allows U.S. companies to be more nimble when cutting costs due to slowing growth. In contrast, non-U.S. companies tend to have higher fixed costs that provide more operating leverage when economic growth accelerates.

A third relates to the well-established legal and oversight systems in the U.S. that typically provide more disclosures and visibility into a company's business, and by implication less relative risk. And, of course, the U.S. dollar's reserve currency status also supports higher valuations and deeper asset markets as international investors need somewhere to park their dollars.

So, there are clear reasons to support a valuation premium in U.S. stocks relative to overseas markets, but we would argue that the pendulum may have swung too far, particularly if the previously stable taxation and regulatory environment becomes more uncertain. While the P/E difference between U.S. and European stocks has typically ranged between one to four points over the last bull cycle, the difference at the end of 2024 was a startling eight points (see chart below).

Will international investors shop around for cheaper opportunities?

Historical price/earnings (P/E) multiples



Source - RBC Wealth Management, FactSet; P/Es as of 5/30/25 based on next-12-month consensus earnings estimates

A WORLD OF OPPORTUNITIES?

Is the U.S. running low on fiscal firepower?

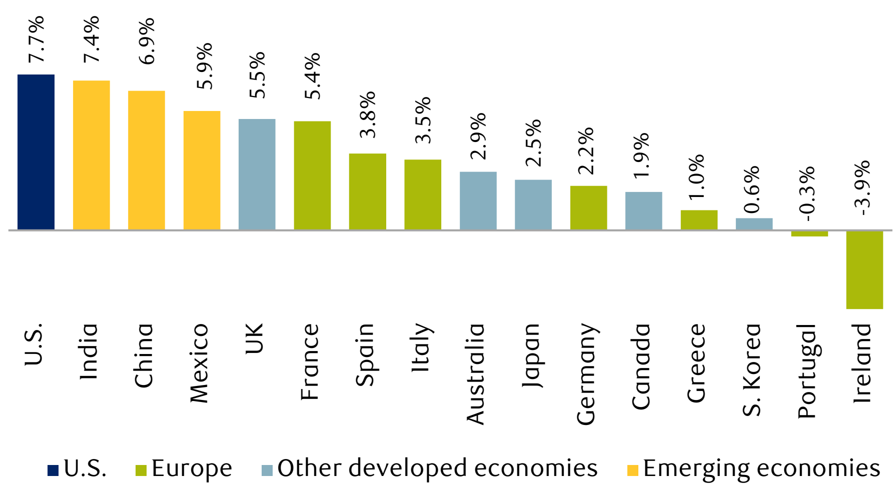
The Trump administration's push to renew the tax cuts introduced in the 2017 Tax Cuts and Jobs Act, and to add significant additional tax breaks, has refocused the market's attention on U.S. fiscal sustainability. The U.S. government ran a fiscal deficit of 7.7 percent in 2024 (the fiscal deficit combines the budget deficit plus government borrowings). This was the widest deficit of any major country and may expand further if the proposed tax cuts eclipse any resulting economic growth.

This can be negative for U.S. assets in two ways: it can drive up interest rates as bondholders ask for more compensation for the added risk, and it can dampen the economic thrust that fiscal stimulus brings to bear as the government bumps up against spending limits. And slower economic growth is clearly a headwind for stocks.

Other countries are in a less onerous position (see chart below). Many developed nations keep their fiscal powder dry in anticipation of economic downturns, and some have now started spending as the global economy slows, with Germany a clear example. If other countries have more fiscal flexibility than the U.S., their asset markets may fare better.

The fiscal punch bowl may start to run dry

2024 annual fiscal deficits as percentage of GDP



Source - RBC Global Asset Management, RBC Wealth Management, International Monetary Fund

An international hedge

The combination of global rebalancing and a weaker dollar has acted as a strong tailwind for international stock performance for U.S.-based investors through the first five months of 2025. There is evidence from fund flow data that non-U.S. investors are pulling their assets back closer to home, and the cracks in the geopolitical landscape caused by the tariff changes appear to be pushing some countries closer together.

Examples include the "EU reset" that may bring the UK closer to the EU in some economic areas after the turmoil of Brexit and vocal support for Canada's nationhood from the British monarchy. This lowering of economic and geopolitical barriers outside of North America may provide new support for overseas growth, in our opinion. And this may be supported by

A WORLD OF OPPORTUNITIES?

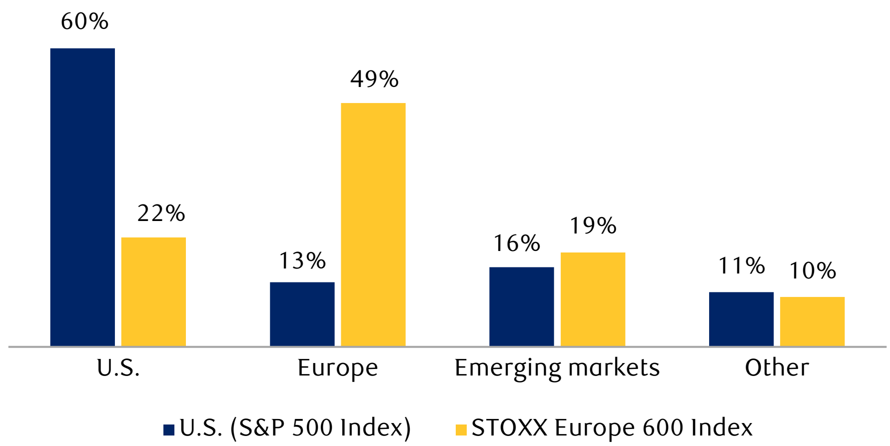
the growing gulf in fiscal flexibility that overseas economies have relative to the U.S.

On the other hand, the U.S. economy and equity markets retain significant advantages over their international peers. Artificial intelligence investments continue to favor U.S.-based software and technology infrastructure companies, and the potential for an increase in U.S. onshoring of manufacturing may provide a boost much further down the line.

Against this backdrop, we would not chase the international outperformance seen this year, but we would also not want to be underweight international stocks in a long-term portfolio. A balanced portfolio of high-quality international stocks at reasonable valuations remains an important asset allocation component for long-term investors, in our view.

Similar businesses, different customers

U.S. and European stocks' revenue exposure by region



Source - RBC Wealth Management, FactSet estimates for 2025

And if economic growth patterns diverge over the medium term, balanced exposure to end markets in different parts of the world (see chart above) should moderate the risk of an economic misstep in any individual market.

MIDYEAR
Focus

U.S. debt: Changing facts, updating views

For years we have taken the position that investors could—and should—ignore the amount of U.S. government debt outstanding when building investment portfolios. While we had concerns on the inflationary aspects of budget deficits, we were explicit in our view that it would be a mistake to invest based on what we saw as media hype around U.S. debt. Our prior view that the U.S. government debt level could be safely ignored by investors was—we believe—correct for its time but is no longer valid.

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Key points

- **We think investors need to be cognizant of the fundamental unsustainability of U.S. fiscal dynamics and what we view as a high probability that markets—not politicians or even voters—will be the catalyst for change.**
- **We believe global diversification and volatility management are the best responses to rising debt levels.**
- **The sooner markets reject the current dynamic, the better, in our view. We think the costs of the intervention and correction will mount the longer the rejection is delayed.**

Our previous view, we believe, was demonstrably correct. Federal debt outstanding is at a record level in dollar terms, but U.S. equities are at or near all-time highs, and the heart of the Treasury curve—securities maturing in three to 10 years—is among the best-performing segments of the U.S. bond market. Clearly, a portfolio that positioned for a U.S. asset price collapse based on record borrowing would have performed poorly.

Why now?

Facts, however, have changed and so has our view. We no longer believe investors should completely ignore the U.S. debt when building portfolios. Instead, we think they need to consider the market implications of government borrowing at an unsustainable pace.

What remains consistent, however, is that we do not believe fiscal policy should become the sole factor in decision making, and we remain firmly convinced that any discussion of a potential U.S. debt default is wildly speculative.

In short, we think the luxury of ignoring Treasury debt is gone, but that fleeing U.S. assets blindly remains a critical mistake.

Our rising concern on the U.S. debt level is a result of the interplay between various fiscal dynamics but boils down to the magnitude of the current debt, the pace of U.S. borrowing, and a potential unfavorable shift in lender incentives. These trends are accelerating the date at which the U.S. will

Atul Bhatia has over 20 years of financial markets experience, primarily in portfolio management and proprietary trading. Since joining RBC Wealth Management in 2020, he has focused on macroeconomic analysis and yield curve management strategy. He is a frequent contributor to Global Insight and a member of the firm's U.S. fixed income subcommittee.

U.S. DEBT: CHANGING FACTS, UPDATING VIEWS

need to confront its debt, and the total lack of response by voters and politicians leads us to believe markets will have to play the key role in driving change.

Looked at in more detail, our key concerns are:

- **Magnitude of the debt and deficit:** In the years leading up to the COVID-19 pandemic, U.S. budget deficits were running between 2.6 percent and 4.7 percent of GDP and debt held by the public was less than 80 percent of GDP. Historically, if a crisis hit, the budget deficit would expand dramatically, but when the crisis passed, the deficit would drop, often to less than 2.5 percent of GDP. That was not ideal, but it was manageable. In contrast, the post-COVID, "new normal" approach of adding 6.5 percent of GDP deficits to an existing debt stock equal to or above GDP is neither ideal nor, we believe, manageable.

- **Apparent inability for a political fix:** No politician admits they are pro-debt funded deficits, but actions speak louder than words. Under both Democrat and Republican presidencies, with various Congressional makeups, we have seen budget-busting programs—whether infrastructure projects or unfunded tax cuts—prioritized over a return to manageable deficit levels.

  When it came to fiscal balance, the current administration arrived with two potential advantages. One was the Department of Government Efficiency (DOGE). The other was a razor-thin Congressional majority that gave significant negotiating leverage to fiscal conservatives. Despite this promising backdrop, the administration is now advancing legislation that will add trillions of dollars in debt over the next decade. We had our doubts going in, but at this point we believe it is impossible to credibly maintain that—absent external pressure—politicians will be able to achieve fiscal balance.

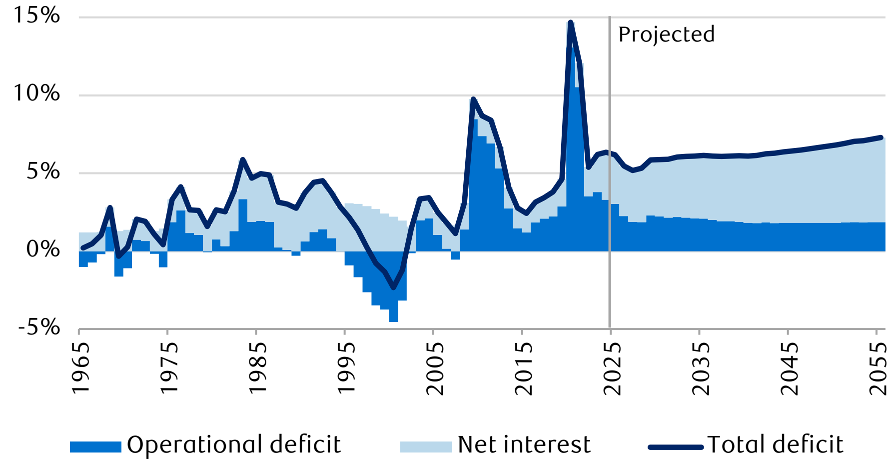
- **External pressure may mean market pressure:** External pressure, we believe, means either voters or markets. Voter pressure would be ideal—it would allow for a well-planned, multiyear approach to slowing and then reversing fiscal trends. But like most ideal solutions, we fear it may prove elusive. Instead, we think that it will ultimately be market pressure—in the form of higher bond yields, lower stock prices, and/or a weaker dollar—that leads to a reversal of current trends. For the move to matter, we think it would have to be sharp and significant.

- **Fading interest means rising interest?** Overseas investors own about a one-third of all Treasury debt. One consequence of lowering the U.S. trade deficit will be reducing the number of dollars that get recycled into government bonds, limiting a vital, and largely price-insensitive, buyer of Treasuries. Overseas investors may also be nervous about Section 899, a proposed change to U.S. law that would allow a president to impose tax surcharges on investors from countries with "discriminatory" tax codes. Absent a robust international borrower base, government financing costs are likely to increase, pulling forward concerns about debt sustainability. As the chart below illustrates, higher interest rates mean faster debt accumulation, as more and more debt sales are required to keep up with financing costs on previous deficits.

U.S. DEBT: CHANGING FACTS, UPDATING VIEWS

High interest rates give the U.S. less budget flexibility

Financing costs for existing debt increasingly drive deficits



Source - RBC Wealth Management, Congressional Budget Office

Put simply, the U.S. has more debt, bigger deficits, and worse fiscal prospects than it did only five or 10 years ago. Combined with an alienated lender pool and myopic politicians, we believe investors must factor in debt dynamics to their investment process.

Bound to bonds

Given that backdrop, should investors flee U.S. Treasuries? Absolutely not, in our view. We still expect bonds to provide important downside protections in a recession or as the Fed cuts interest rates to stimulate economic growth. Nor do we think investors should be particularly concerned about default risk. At the end of the day, the U.S. borrows in dollars and can issue dollars at will. As a result, we think the likelihood of timely repayment of Treasuries remains incredibly high.

But we do think investors would be wise to think about how far out they go on the Treasury curve, and how much additional yield they get for volatility risk. After all, the process of markets "forcing" the government to care about debts is a potentially stomach-churning rollercoaster of price drops. A little additional yield and avoiding or reducing exposure to 30-year Treasuries could be a nice dose of preventative medicine.

Don't run, diversify

When it comes to equities, we think the argument in favor of U.S. exposure is even more obvious. The U.S. remains a large, vibrant economy with plentiful natural resources; a creative, talented labor force; and cutting-edge technology. There is no argument we see for exiting an economy with those characteristics, particularly since most other leading economies suffer from their own debt and deficit concerns.

Remaining in U.S. equities, however, is a far cry from remaining exclusively in U.S. equities. As our other Midyear Outlook article, "A world of opportunities?", makes clear, there are strong arguments in favor of internationally diversifying an equity portfolio. Potential debt-related volatility in U.S. assets is just another incentive.

U.S. DEBT: CHANGING FACTS, UPDATING VIEWS

We think it's equally important for investors to consider how a shrinking federal budget deficit—whenever it happens—could impact U.S. stock prices. One reason for the current high level of corporate earnings is the impact of rampant government spending. A large chunk of that 6.5 percent debt-funded deficit eventually finds its way into corporate income statements. A shift toward greater fiscal balance—if it is not well-planned—could lead to earnings headwinds for some companies.

Inevitable, but perhaps not imminent

Our view is that some form of market reaction to deficits and debt is becoming, or more likely has become, inevitable. But inevitable is a far cry from imminent. Folks have been railing against the danger of U.S. debt for nearly half a century, without any investment success to date. We are extremely aware that Japan runs a debt-to-GDP ratio nearly double that of the United States, and that Treasuries are issued in U.S. currency under U.S. law—powerful advantages.

Timing the end of a dynamic that has existed for 50 years is fraught with difficulty, and it could easily be a matter of months, years, or even decades before there is any significant move by investors to push back on U.S. borrowing. We feel confident, however, saying that the longer the U.S. waits to address its debt issue, the greater the likely cost for investors and taxpayers.

Not the beginning of the end, maybe the end of the beginning?

For investors, risk typically lies on a continuum. At a certain level, a theoretical risk is largely irrelevant for price formation. At the other extreme, a negative outcome is seen as so likely that it dominates investor thinking. Between those two extremes lives the messy world of price formation.

Up until now, we've largely thought of the federal debt as lying at the good end of the risk spectrum—a theoretical concern with little practical implication. We now believe that we've entered the messier terrain of thinking about when and how the pace of debt creation in the U.S. can be brought to heel.

GLOBAL

Equity

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Certain uncertainty

Markets are often said to "climb a wall of worry." If that's so, there looks to be lots of climbing left. We expect major equity markets to post new highs in the months ahead, but there are caveats, and we advise a cautious, watchful approach.

Key points

- **Markets have largely recovered from their February-April swoon, leaving investors to contend with elevated valuations amidst policy and geopolitical uncertainty.**
- **Consensus earnings estimates for this year and next are robust enough to support those valuations as long as trade uncertainty doesn't bring the prospect for a U.S. recession back onto the table.**
- **Supportive measures of advancing market breadth add to our conviction that more new highs lie ahead for the major markets, but we expect the path taken by equity indexes to be a bumpy one as the impacts of tariffs and counter-tariffs work their way into the earnings and valuation equations.**

The first half of 2025 is mostly in the books. Following is our look at equity market expectations as they stand for the rest of this year and for 2026.

Over time, the value of businesses grows in step with corporate earnings, which in turn are largely determined by the direction and magnitude of GDP growth. Looked at from the negative point of view, major stock market retrenchments have typically occurred around periods when corporate earnings are stagnating or in outright decline.

The worst and longest-lasting of such market declines, for all the world's major markets, have been associated with U.S. recessions, which leaves open the question: Is a U.S. recession likely to arrive in the coming 18 months?

Just a couple of months ago, surveys of consumers, businesses, and investors offered up a deeply pessimistic "Yes" to that question. The overwhelming view at the time had the U.S. entering recession by the second half of this year or by early next year at the latest. That extreme low point for sentiment coincided with a scary low for stock prices—the S&P 500, for its part, had fallen almost 19 percent in just six weeks, from which it has largely, but not yet completely, recovered.

The same was true for the MSCI indexes for the UK and Europe as well as Japan's TOPIX. Surprisingly, Canada's S&P/TSX, after falling by a shallower 15 percent, sprinted to a new all-time high, the only major index to do so as yet. All the more noteworthy because the heavyweight Energy sector (approximately 20 percent of the TSX Index) was laboring under weaker oil and natural gas prices over much of that interval, while as the largest trading partner of the U.S., Canada's economy has been contending with massive trade/tariff uncertainty.

Meanwhile, those sentiment surveys cited above have all improved somewhat but are still, on balance, set at pessimistic readings—that is to say, a long way from the extended over-optimism that often spells trouble for the stock market. It is also true that surveys require careful interpretation. In this case, despite the extremely downbeat moods of both consumers and company CEOs, spending by both households and businesses has remained resilient.

GLOBAL EQUITY

Importantly, in our thinking, "market breadth" in the form of the so-called advance-decline line for the S&P 500 has recently set yet another new all-time high, suggesting the index won't be far behind in following suit.

With breadth readings like this, we think there is room for the major global equity indexes to go on moving higher for some time yet, but there are caveats.

Recession needs to be avoided

The negative GDP data in Q1 reminds us that there continues to be great uncertainty about the potential impact of tariffs on the U.S. economy and those of all its trading partners. The unwillingness of most companies to provide forward guidance underscores this. We believe another sustained up-leg in equity markets requires a catalyst which opens a plausible path to continued growth without recession.

The most welcome would be a trade deal between the U.S. and one of its notable trading partners—the EU, China, Canada, and Mexico represent about 60 percent of U.S. imports. So far, no such deal has emerged. With postponed tariffs set to take effect in the coming month, the impact on inflation and Federal Reserve policy could unfold over the second half of the year. At the moment, the U.S. central bank looks to be wary of cutting rates ahead of a price shock it assumes will be coming. The same looks to be increasingly the case for other central bank policymakers.

Rich valuations require constant reassurance

Consensus earnings estimates for the S&P 500 remain unreservedly optimistic. This year is currently expected to come in at $265 per index share, up by 7.5 percent, with next year forecast to advance by a booming 13 percent to $300. And investors look to have embraced these estimates wholeheartedly: today the index trades at 22.8x this year's earnings estimate and 20.1x next. (At the market's February high, which we think will soon be surpassed, those valuation multiples lift to 23.2x and 20.5x.)

Equity views

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

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

RBC Capital Markets, LLC Head of U.S. Equity Strategy Lori Calvasina notes that there is usually some erosion in consensus estimates over the course of the reporting year. Reflecting that factor and the firm's forecast of soft GDP growth, her 2025 estimate is a more-sober-than-consensus $258. Applying an average "erosion factor" from here, 2026 earnings might turn out to look more like $273 per share, still up a respectable six percent. Using these "eroded" estimates, price-to-earnings (P/E) ratios at the S&P 500's recent all-time high come in at 23.8x and 22.5x, respectively.

Here it should be noted the broad indexes in Canada, Japan, Europe, and the UK are at comparatively much less demanding multiples—the mid-to-high teens for the first three and only 13x for the UK. The P/E gap for all four vis-à-vis the U.S. would narrow to some degree if one adjusted for sector weight differences; the U.S. market has much higher exposure to the high-P/E Tech sector and much lighter to the low-P/E Materials and Financials groups. What valuation gap remains is largely attributable to the preponderance of mega-cap growth stocks such as the "Magnificent 7" (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla) found in the S&P 500.

GLOBAL EQUITY

Markets, even high P/E ones, can withstand some near-term earnings disappointments, like those that might arrive in the wake of full-on tariff (and counter-tariff) imposition in H2, as long as investors can remain confident of a 2026 full recovery. However, in our view, “withstand” does not mean “ignore.” A rocky H2 for earnings, should it arrive, could be expected to take a periodic toll on investor confidence and produce bouts of downside volatility along the way. And, while forecasts of a 2026 U.S. recession, so prevalent two months ago, have largely faded away, they could come back on the table just as rapidly.

Other risks abound

Earlier in the year, we argued that catalysts were needed to make a sustained path higher for stock markets plausible. Our first choice was “some significant improvement on the trade front” and it still is. However, we also thought “a Ukraine truce would be helpful.” Regrettably, the Ukraine-Russia conflict has escalated in the interval, diminishing the prosects for a negotiated ceasefire or path to a peace settlement. Now, an already highly fraught Israel-Iran relationship threatens to transmute into outright war, perhaps pushing any possible U.S.-Iran nuclear deal into the ditch along the way. And still lurking on the sidelines is the until recently, very hot confrontation between nuclear powers India and Pakistan.

Invested, but watchful

Markets are often said to “climb a wall of worry.” If that’s so, there looks to be lots of climbing left to do. But stock markets shouldn’t be thought of as infallible oracles that correctly divine the future. Rather, they are the collective view of investors about what lies ahead. Those all-too-human investors can and do change their minds—often abruptly. There may be plenty of reasons presented to do just that in the coming quarters.

We expect major equity markets to post further new highs in the months ahead. But we also believe something more than “the trend is your friend” thinking will be required. Good investment decisions are that much harder to make when being pressured by either fear of missing out, or just plain fear.

We advocate for a cautious, watchful approach.

Regional equity perspectives

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United States

Despite significant volatility in the spring caused by ultra-high tariffs—including an S&P 500 selloff of nearly 19%—major U.S. indexes are now close to where they were when the year began.

The worst of the tariff volatility seems to us like it's blown over. RBC Global Asset Management estimates the U.S. average effective tariff rate will end up between 13%–15%, far lower than the 22%–27% range before the Trump administration backed away from sky-high tariffs. But we believe 13%–15% is still elevated enough to generate economic headwinds and uncertainties given this would be the highest rate since 1941 and is well above the 2.4% level in 2024.

Below-average GDP growth the likes that RBC Economics is forecasting—1.6% in 2025 and 1.3% in 2026—could mean that S&P 500 earnings end up growing more moderately than the consensus forecast. RBC Capital Markets anticipates earnings of $258 per share in 2025, which translates into 4.5% y/y growth, below the consensus forecast of $265 per share and 7.5% growth. With Fed rate cuts potentially resuming in the autumn and picking up pace next year, we think investors' attention will soon focus on 2026 earnings prospects. While the consensus growth forecast seems too high to us, even moderate growth in 2026 could help support the market so long as recession risks don't rise meaningfully.

Wall Street will continue to keep an eye on Washington policies, but they will likely have less impact on the market than during the tariffs saga. We think Senate and House Republicans will be forced to ultimately craft compromises on the "One Big Beautiful Bill Act" out of political necessity—although the process could get very messy. It's our sense that the market has already largely priced in the pro-consumer tax provisions and the pro-business incentives within the bill.

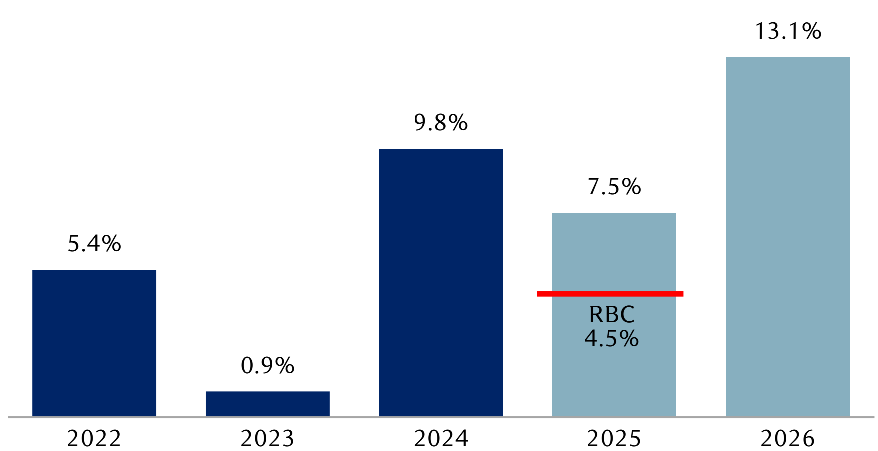
Given the lingering economic and earnings growth risks, along with stretched valuations, we continue to recommend investing in U.S. equities up to but not above a normal, Market Weight level. We still favor dividend growth stocks and like Technology stocks.

Canada

The Canadian equity market has had a turbulent first half of the year, with a steady but modest downdraft leading up to "Liberation Day," followed by an easing of fears amid constructive dialogue out of the White House. The TSX has since risen

Earnings growth likely below consensus forecasts

S&P 500 past year-over-year earnings growth (dark blue) and consensus forecast (light blue)



Source - Bloomberg (past earnings growth and consensus forecasts for 2025 and 2026), RBC Capital Markets U.S. Equity Strategy (2025 forecast of 4.5%); data as of 6/16/25

REGIONAL EQUITY PERSPECTIVES

double-digits and has rallied to a new all-time high. Notably, gold has continued to be a material driver of this performance. The strong run-up in gold (up approximately 25% year to date) bolstered investor sentiment towards gold miners, as higher bullion prices helped drive operating leverage and strong earnings growth. Much of the strength in gold has been driven by global central bank buying. China's gold imports reached an 11-month high, increasing 73% m/m in April, as the People's Bank of China (China's central bank) eased restrictions on bullion inflows. Gold is also widely viewed by investors as a hedge against geopolitical, inflation, and U.S. dollar risks, and we believe these factors may keep gold prices elevated for the foreseeable future.

Furthermore, bank valuations now sit at a premium to historical averages, which have us questioning how much higher they can run. While RBC Capital Markets has updated its fiscal 2026 and 2027 estimates to include robust earnings growth and a normalization of provision for credit losses, we continue to monitor a broader environment of slowing loan growth and consumer credit risk.

As we look ahead, inflation has recently firmed up, and we think the path of the Bank of Canada's interest rate policy will be largely determined by the extent of further softening in the economy. Global trade uncertainty continues to drive cautious sentiment among investors despite 2025 consensus earnings estimates for the TSX indicating roughly 9% growth, which would be a healthy level. The TSX's valuation has climbed higher over the course of the year, now sitting at 15.8x forward price/earnings, compared to the 10-year average of 15x. In similar fashion, equity risk premiums (the extra return investors require above a risk-free investment) are also below the longer-term average, indicating to us that investors may be looking through some of these near-term risk drivers.

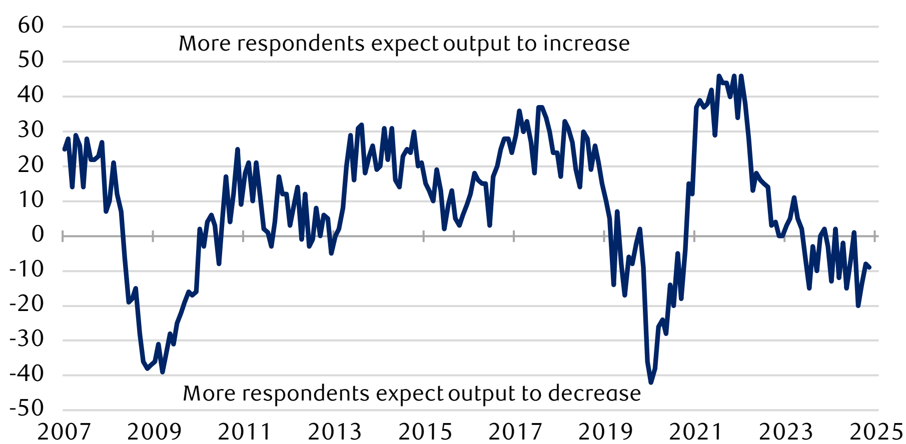
UK

Following a cautious start, the Labour government has achieved two milestones: a rapprochement with Europe along with possible further steps in the future and a 'trade agreement' with the U.S. Though the 10% baseline U.S. tariff remains, there is some tariff relief for UK cars, steel and aluminium, resulting in an 11% average U.S. effective tariff rate on UK imports.

While these are important achievements, we believe the impact on the UK economy is likely to be muted. The re-engagement with the EU merely rolls back some of the obstacles introduced by Brexit, while the new average effective tariff on UK exports is not substantially different from what would have applied had the reciprocal tariffs remained in place.

UK business sentiment has deteriorated

CBI Industrial Order Expectations



Source - Confederation of British Industry

REGIONAL EQUITY PERSPECTIVES

The UK economy started the year on a reasonable footing, but in our view, large increases in taxes and energy costs will likely hinder economic growth. Surveys by the Confederation of British Industry and market research company GfK point to continued deterioration of business and consumer confidence. RBC Capital Markets expects GDP growth of only 1.0% in 2025 and 0.9% in 2026.

The government is attempting to tackle the sluggish economy with plans for homebuilding, defence and infrastructure spending. The Prime Minister announced an increase in defence spending to 2.5% of GDP by 2027 from the current 2.3%, with further increases likely, while the Chancellor set aside £113 billion for infrastructure projects over the current parliament. Taxes, as well as borrowing, will probably have to rise even further.

For large-cap equity investors, attractive valuation levels matter more than the domestic backdrop. The latter tends to have a more pronounced impact on small-cap equities.

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, quality UK large-cap stocks trading at a valuation discount to foreign competitors are an attractive opportunity for global investors, in our view. We also favour attractively valued Financials, given their high level of shareholder returns via both dividends and share buybacks.

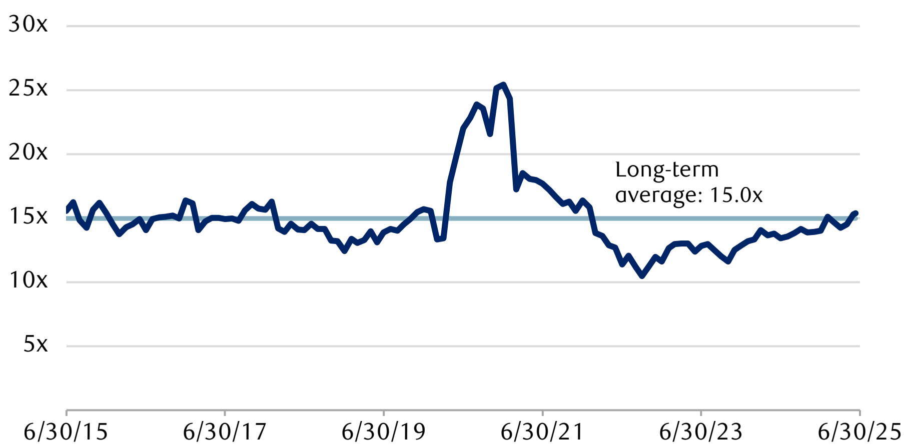
Europe

Europe is beginning to tackle its structural issues, possibly paving the way for substantial and lasting change. The introduction of new fiscal measures, with the EU aiming to boost defence spending and Germany spending more on infrastructure, should provide some support to the economy even as U.S. tariffs act as a headwind.

U.S.-EU trade tensions center on EU food hygiene standards and the region's digital and value-added tax provisions. The EU's offer to purchase U.S. LNG and defence equipment or cut its own industrial tariffs on the U.S. to zero may not be sufficient to prompt the U.S. to lower its tariffs on the EU. As it stands, the average U.S. effective tariff rate on EU goods now reaches 11%. This is a significant increase from the 2% rate in effect at the beginning of the year and it poses a substantial headwind for exporters. If a trade framework is not agreed to soon and the U.S. does not back down from current tariffs in place, then we believe the EU is very likely to retaliate by raising tariffs on up to €100 billion in U.S. imports. Such an

European equities trade roughly in line with the historical average

MSCI EMU (Economic and Monetary Union) Index 12-month forward P/E ratio



Source - RBC Wealth Management, Bloomberg; data through 6/10/25

REGIONAL EQUITY PERSPECTIVES

escalation would likely hit European GDP growth this year.

Europe, especially Germany, has resorted to fiscal stimulus amid possible U.S. security and defence support cuts in the region. We expect this stimulus could lift the EU GDP by some 0.3 percentage points in 2026 and 2027, mitigating the impact of tariffs. RBC Capital Markets expects GDP growth for the euro area to reach 1.6% in 2026.

The MSCI EMU (Economic and Monetary Union) Index, a proxy for European equities, trades at a price-to-earnings valuation of 15.4x 12-months forward consensus earnings forecast, roughly in line with its long-term average. It also trades at a discount to U.S. equities even on a sector-adjusted basis. We prefer sectors likely to benefit from the fiscal stimulus, such as select industrials, including defense, and materials. In our view, banks should benefit from the region's improved medium-term growth outlook and a steeper yield curve, while continuing to offer attractive shareholder returns via dividends and share buybacks. We are mindful that sectors subject to tariffs as well as those exposed to a strong currency are less likely to outperform.

Asia-Pacific

We expect Chinese equities to be largely range-bound in H2 2025 after a strong first-half performance. Two major performance drivers will likely be U.S.–China trade negotiations and corporate earnings.

The U.S.-China 90-day tariff truce will end on Aug. 10. While the worst-case scenario has been avoided, news on further trade negotiations would likely fuel market volatility.

Meanwhile, investors are monitoring signs of fundamental recovery. Chinese companies' earnings-per-share (EPS) revision trends have been leading regional peers since the beginning of the year. First-quarter corporate earnings were generally upbeat, but mixed results from several large technology and consumer companies highlighted heightened industry competition, increased investment, and profit margin pressure. With tariff impacts starting to materialize, we think investors will pay attention to earnings resilience and whether EPS recovery can support further valuation expansion. Regardless, we anticipate additional government reforms, such as greater market access, industrial policy changes, and policy stimulus, could potentially provide upside surprises for the market.

For Japan equities, we think a Japan-U.S. trade deal is likely but may not occur until after July's elections for the upper house of Japan's legislature. Japan's equity market has priced in tariff cuts, and price action related to this in the auto sector appears too optimistic, in our view.

Japan's upper house election is to be held by July 22. Given the poor showing in the October 2024 snap election, which saw the incumbent Liberal Democratic Party (LDP) lose its majority for the first time since 2009, we think this election bears watching. We do not rule out a brief period of political instability if the LDP position is further weakened. Given most opposition parties have called for a lower consumption tax, the ruling party may need to make concessions on this front to shore up support.

Notwithstanding the political headwinds, we maintain our constructive view on the Japan equity market as a sustainable 2% inflation target seems in sight and other factors should be supportive such as the renewed investment from friend-shoring and on-shoring, improving return-on-equity and shareholder returns, resilient domestic demand supported by high savings and wage hikes, inbound tourism, and elevated domestic retail inflows under the revamped Nippon Individual Savings Account scheme.

GLOBAL

Fixed income

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A short fuse on long bonds

Market volatility is unlikely to dissipate anytime soon. But while fixed income markets have weathered outside factors reasonably well this year, the next source of volatility could come from within—the global bond market itself.

Key points

- **Though most central banks continued to lower short-term rates over the first half of the year, longer-term sovereign bond yields defied rate cuts to move higher.**
- **While there are numerous reasons long-term bond yields are shifting higher, sovereign debt levels and risks, particularly in the U.S., the UK, and Japan, are increasingly becoming drivers.**
- **Though a risk, we continue to believe deteriorating economic fundamentals will be the primary driver of yields, which will see them fade modestly in the second half of the year.**

If volatility was the main market narrative of the first half of the year, we expect the second half's to be, well, more volatility.

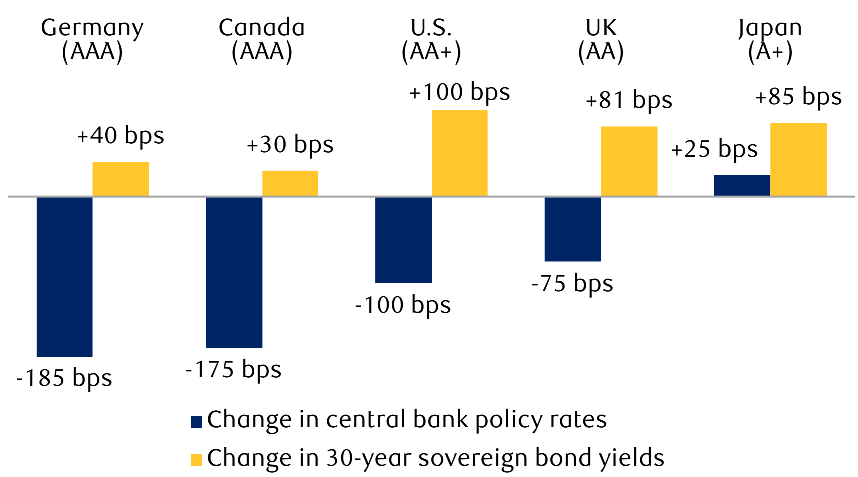
Global bond markets have had to contend with issues on numerous fronts, and on all sides. Issues such as tariff-related inflationary risks have argued for higher yields, where the potential for tariff-induced slower economic growth would argue for lower yields.

Though the trade war seems to have somewhat dissipated into the background for now, tariffs remain both highly uncertain and likely to have ripple effects into the second half of the year. And as is often the case, one source of volatility is more likely than not to simply be replaced by another. The next risk for global bond markets may come from inside the building—sovereign bonds.

Lower interest rates, higher yields

The first chart points to budding risks around government finances. While most major central banks—save for Japan—have been slicing short-term interest rates, longer-term sovereign

Despite central bank rate cuts, bond yields keep rising



Source - RBC Wealth Management, Bloomberg; shows net change from 9/1/24 through 5/30/25; composite credit ratings from major rating agencies; Germany used as proxy for European Union; European Central Bank rate cuts shown

GLOBAL FIXED INCOME

bond yields have not only failed to follow, they have moved in the opposite direction entirely.

For example, since the Federal Reserve delivered the first of a series of rate cuts in September 2024, which ultimately amounted to 100 basis points, longer-term Treasury yields have risen by an equal amount; a similar story has played out in the UK.

While the rise in Japanese long-term yields may not be as surprising given modest rate hikes from the Bank of Japan (BoJ), much of the recent spike came on the back of unexpectedly weak investor demand at bond auctions in May. Investors seem to have stayed away amid rising concerns about Japan's worsening fiscal trajectory.

Fiscal focus

And therein lies what could be the next source of market volatility this year—sovereign credit fears.

Though long-term bond yields have also risen in Germany and Canada despite even deeper rate cuts from both the European Central Bank and the Bank of Canada, the more modest move higher may simply reflect fewer credit concerns.

Following Moody's downgrade of the U.S. credit rating in May, the U.S. now holds an average credit rating of AA+, the UK is rated AA, and Japan is A+.

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

What about Canada and Germany? Both are still rated AAA with few looming concerns on the fiscal front, in our opinion.

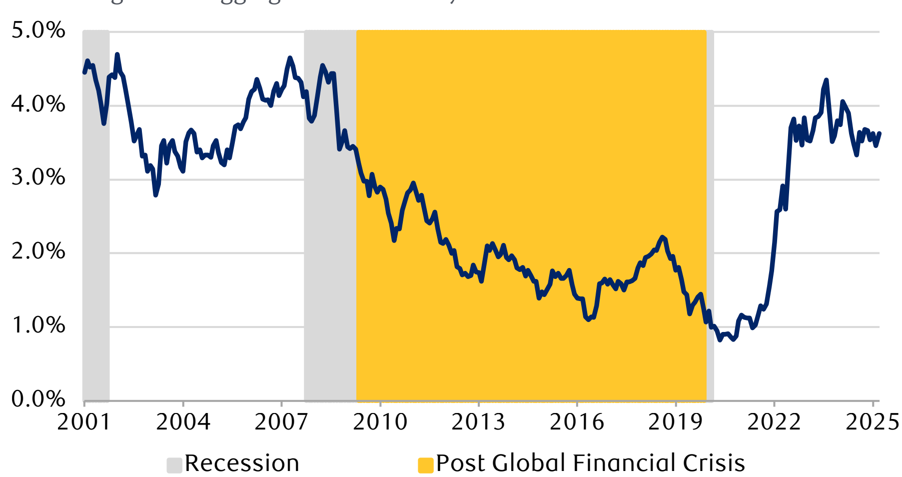
The UK has battled its own budget concerns in recent years as bond markets most notably pushed back forcibly on previous tax cut and deficit expansion plans in 2022. In the first quarter of this year, UK government financing needs hit one of the highest levels on record as the yield on 30-year Gilts breached 5.6%, the highest level since 1998.

Then there's the United States. While fiscal deterioration is nothing new—and reasonably well-weathered by markets for decades—things risk coming to a head later this year.

One factor in Moody's decision was the expectation that the "One Big Beautiful Bill Act" would add

The era of low rates has been left behind

Bloomberg Global Aggregate Bond Index yield



Source - RBC Wealth Management, Bloomberg

GLOBAL FIXED INCOME

$4 trillion to the deficit over the next 10 years and that annual deficits would rise to around 9%, and that's assuming steady economic growth and full employment. Slower growth and/or an outright economic downturn would likely only increase the deficit.

Though the final form of the bill remains to be seen, and the bias appears toward being less of a deficit buster in the Senate, we think U.S. deficits will almost certainly continue to trend in the wrong direction.

That will keep the focus on government bond auctions, and how governments plan to finance themselves. After May's spike in yields, the BoJ has seemingly been able to calm markets by floating the idea of reducing long bond issuance levels if demand is lacking. In the U.S., the Department of the Treasury could also go down that path should there be signs that domestic and foreign interest is lacking. That could serve to help keep long-term yields lower, but there are also risks of shorter-term issuance and refinancing risks, not to mention that the department may already be overly reliant on short-term financing. There may be only bad, and not as bad options, and that could be a lingering source of volatility itself.

Economic knock-ons

Finally, market optimism might be getting ahead of itself. Global risk assets have seemingly been buoyed by central bank easing, but it may only be phantom easing.

For example, when the Fed started cutting short-term rates last September, the benchmark 10-year Treasury yield was 3.6% and the average 30-year mortgage rate was 6.6%; at the end of May, those two metrics were higher at 4.4% and 7.0%, respectively.

Despite the attempts of the Fed and other central banks to deliver policy-easing measures, those efforts may not have had the desired impact. The weight of higher sovereign bond yields—which tend to have a lagged impact— could still pose a risk to economic activity globally through the end of the year.

Risks, but paid for the risks

Global bond yields appear stuck between the threat of persistent inflation and higher debt levels on the upside, and slowing economic growth and rising unemployment on the downside.

The simple assumption would be that yields remain rangebound the rest of the year. That said, we think that a slowing growth backdrop will eventually prevail as the dominant driver of yields, and that global yields will generally trend modestly lower into the end of the year.

And if there's an upside to swelling sovereign balance sheets, it's that fixed income investors now have more options, and more yield. As the second chart shows, the post-global financial crisis era of subdued government spending, sluggish growth, and non-existent yield levels looks increasingly likely to be relegated to the history books. Despite risks, at least investors are now being compensated for those risks.

Regional fixed income perspectives

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United States

The Fed has taken a wait-and-see approach through the first half of the year, but we expect the second half to provide more seeing than waiting. We believe the Fed will continue to assess the incoming labor market and inflation data over the summer, but we anticipate further cooling in the former as likely to set the stage for another round of modest policy easing, beginning with a first rate cut as early as September.

The benchmark 10-year Treasury yield remains a key market and economic signal for investors. Over the past year it has traded roughly in a 3.75%–4.75% range, ending May around 4.50%. Should its yield break above 4.75%, that could be a sign of renewed inflationary and/or budget deficit risks; levels below 3.75% have typically coincided with economic growth and recession fears. We expect that range to hold, but with softer economic activity expected later this year, we see a modest decline toward 4.00%.

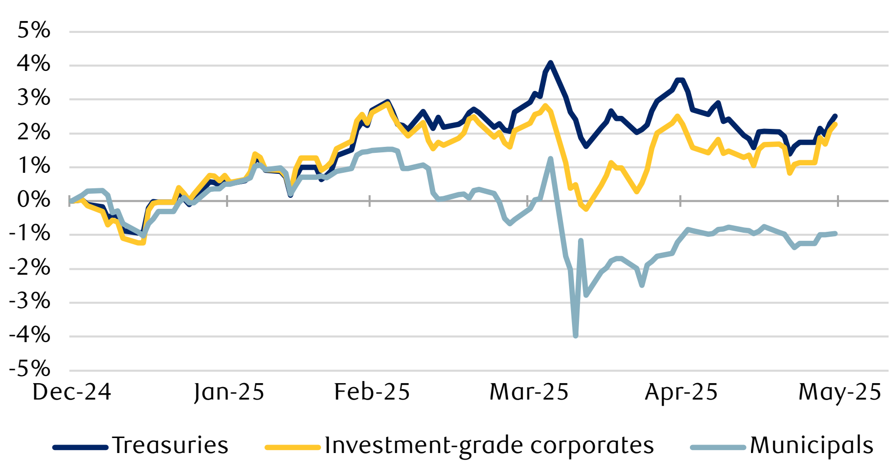
Despite heightened volatility, bonds have provided a semblance of stability. Both Treasuries and investment-grade corporates have delivered positive returns for the bulk of the year, while the municipal bond market has lagged notably. As the chart shows, munis were down 4% at one point in April on a one-two combination of tariff-related volatility and rising fears the asset class was at risk of losing its tax-advantaged status. Though those fears have faded, the continued underperformance may offer entry points for muni investors to put money to work.

Though municipal bond valuations remain relatively inexpensive, corporate bond valuations are once again historically expensive. Over the past 25 years, corporate bond investors have, on average, been paid an additional 1.5% in yield over comparable Treasuries; after the market recovery since April, that yield advantage is barely half that at just 0.8%. Therefore, corporate bonds may now offer more downside risk than upside potential but, absent a recession, we expect them to perform similarly to Treasuries into the end of the year.

Canada

With domestic inflation already near the Bank of Canada's (BoC) target, we see the BoC as having the flexibility to respond to a potential economic downturn by cutting interest rates further. However, we question its need to do so at this time, having already delivered 225-basis points (bps) worth of cuts since mid-2024 and the benefits of those cuts already working their way through the economy. In fact, incoming fiscal stimulus from

U.S. bond market performance in 2025: A mixed bag



Source - RBC Wealth Management, Bloomberg Indexes; data as of 5/30/25

REGIONAL FIXED INCOME PERSPECTIVES

the Liberal Government and positive trade-tariff developments have seen investors begin to question the need for additional economic assistance by the central bank. The BoC remains in a “wait-and-see” mode, looking for stronger evidence of economic deterioration before adjusting policy rates further.

Following a tariff-induced market selloff in early April, cooling trade tensions have seen risk assets rebound and begin to retest pre-tariff levels. A strong equity rally since mid-April has already pushed the Canadian Equity Index above previous peaks, while the additional yield demanded by investors for the risk of default in Canadian corporate bonds, also known as the credit spread, has tightened thanks to improving investor confidence. In fact, most sectors within fixed income have seen credit spreads complete a round trip back to their late-2024 spread levels. All in, corporate-bond spreads in Canada remain below their historical average, indicating to us little sign of significant market concern.

We remind investors that the tariff situation remains fluid and will likely continue injecting uncertainty into global markets. When the yield compensation for risk is this low, investors are vulnerable if the outlook were to deteriorate. This is why we prefer safer categories of the fixed-income market, such as Government of Canada and investment-grade corporation issues rather than riskier categories, such as higher-yielding bonds issued by weaker balance sheet corporations.

UK

The Bank of England (BoE) is on a “careful and gradual” path. While our base case is 75 basis points (bps) of easing through to year end, upside inflation risks remain especially in services, which could apply the brakes on cuts. Wage inflation is still meaningfully above the 3.0%–3.5% level consistent with a 2.0% inflation level, but more importantly recent data shows signs of cooling. Furthermore, we think business hiring intentions will continue weakening, thus limiting wage growth and ultimately headline inflation in H2 2025.

The UK’s fiscal situation is also under pressure, with Q1 government borrowing data reaching the fourth highest on record. The Treasury’s spending needs are high, particularly in healthcare, education, and defence. While higher borrowing costs and lower productivity growth are exacerbating these fiscal pressures, we estimate a fiscal hole of £13–£23 billion depending on spending timelines. The Chancellor has three options to address this: (1) adjust the self-imposed fiscal rules, (2) cut departmental expenditures, (3) or raise taxes.

The Treasury’s decision to skew issuance further towards shorter-dated debt is likely due to declining demand from insurance and pension funds, and to higher longer-dated bond yields. While this tilt towards shorter maturities should be positive for Gilts, fiscal concerns and expectations of stubborn inflation have led to investors demanding higher yields on long-dated bonds. Gilts will remain sensitive to these factors, in our view. In the near term, we prefer short-dated Gilts. For long-term allocations, we think 10-year Gilt yields above year-to-date averages of 4.61% are compelling.

On one hand, corporate fundamentals improved due to rising profit margins in Q1. On the other hand, valuations look rich as credit spreads have tightened to levels below one-year averages. Consequently, spreads are inadequately compensating for credit risk especially in high-yield bonds. Near term, we prefer allocating in low-quality, investment-grade, short-duration bonds to cushion against potentially wider future spreads. We see value in Senior-Ranked Bank bonds, as well as Consumer Staples and Communications sectors.

REGIONAL FIXED INCOME PERSPECTIVES

Europe

We view European Central Bank (ECB) policy rates as "well positioned," suggesting a pause in July, but not marking an end to the rate-cutting cycle. Should growth surprise to the downside, in our view, the ECB in September would make one additional 25 bps cut with a terminal interest rate of 1.75%.

In our opinion, lower wage pressures, lower energy costs, and a stronger euro will continue to support the 2025 disinflation process to meet the ECB's 2.0% inflation target. Economic growth going forward will be impacted by the effective U.S. tariff rate likely remaining above pre-April 2 levels, and we think the surge in Q1 GDP growth is unlikely to persist into Q2–Q4. Despite these challenges, RBC economists expect higher growth of 1.2% compared to ECB estimates of 0.9% in 2025 given the strength in Q1 GDP.

We believe most eurozone governments are likely to continue running sizeable deficits in the near term, and risks of fiscal sustainability could come to the fore. Germany has the fiscal headroom to borrow, but France and Italy already have fiscal restrictions given their high debt levels. Elsewhere, Spain, Portugal, and Greece's debt levels are likely to improve, in our view. But euro area sovereign spreads relative to Germany have tightened, especially in the lower-rated nations and are now in richer territory. Therefore, we prefer an Underweight position in the near term. For long-term investors, we think 10-year German Bund yields above 2.60% present an opportunity to consider adding to positions.

Despite the trade policy headwinds, corporate fundamentals have remained stable with notable improvements in the technology and basic industrials sectors. High-yield bond default rates have ticked higher and are at levels last seen in 2011, so we prefer investment-grade bonds. Following the tariff-relief rally, credit spreads are now tight, and we expect widening, especially in high-yield bonds to year end. That being said, we think there are still opportunities in short-duration investment-grade bonds with compelling yields and an income cushion to mitigate against potential spread widening.

Asia-Pacific

Asia credit markets experienced notable volatility in Q2 2025, driven by U.S. President Trump's "Liberation Day" tariff announcement on April 2. This triggered a sharp widening in credit spreads with Asia investment-grade (IG) widening by 51 basis points (bps) and Asia high-yield (HY) by 167 bps. However, spreads quickly retraced, and Asia HY greatly outperformed Asia IG on the subsequent compression rebound, tightening the HY-to-IG spread premium beyond pre-"Liberation Day" levels.

In China, we believe policy support and further stimulus will be required to stabilize credit conditions, especially in property-related and private sectors. The recent de-escalation in U.S.-China trade tensions, marked by significant tariff reductions, has helped ease immediate downside risks and supported a retracement in credit spreads. However, the U.S. effective tariff rate remains historically elevated, and China continues to face structural economic headwinds, particularly from its ongoing property-sector crisis. We see selective opportunities in China credit space, but credit differentiation is critical.

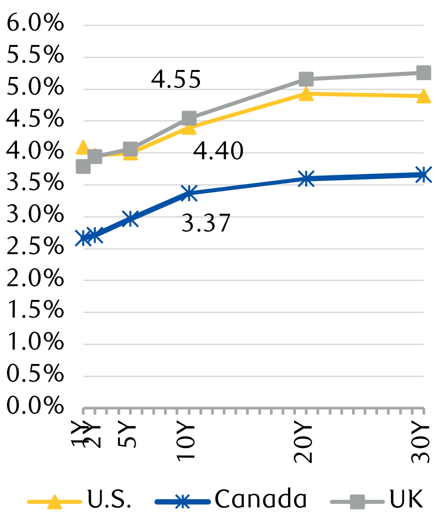
Japan government bond (JGB) yields have made among the highest year-to-date moves across Asia and developed global markets. This is due to several drivers including domestic policy shifts, fiscal challenges and global financial market trends. Domestic institutional investors, such as Japanese life insurers, are among the largest holders of these bonds. Despite these elevated yields, major

REGIONAL FIXED INCOME PERSPECTIVES

Japanese life insurers are taking a cautious approach to the recent spike in JGB yields in April and May; instead, they are net selling JGBs. In our view, this is due to uncertainty over the Bank of Japan's (BoJ) policy outlook, tariff impacts, and potential volatility in ultralong JGB yields. Additionally, major life insurers are also preparing for higher capital requirements to withstand a potential surge in surrender rates, thereby further reducing demand for long-end JGBs and contributing to yield volatility.

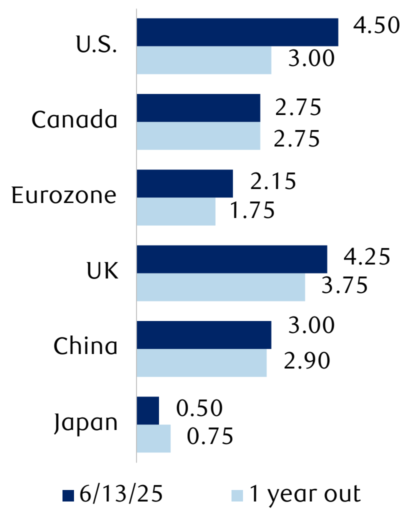
Looking to H2 2025, we expect Asia credit to remain a carry play where returns would be mainly driven by income, with a more defensive bias towards higher-quality credit. We maintain a preference for IG over HY credit, given that much of the "Liberation Day" spread widening has already retraced. This leaves limited room for further compression, particularly in HY. Nonetheless, we believe Asia IG continues to offer attractive all-in yields, currently sitting at the higher end of historical ranges. Much of Asia ex-Japan IG remains anchored by domestic demand, and market expectations of a negative bond supply this year should keep the space well supported. Given the backdrop of moderate economic growth and ongoing macro risks, we favor positioning in higher-quality Asia IG names.

Sovereign yield curves



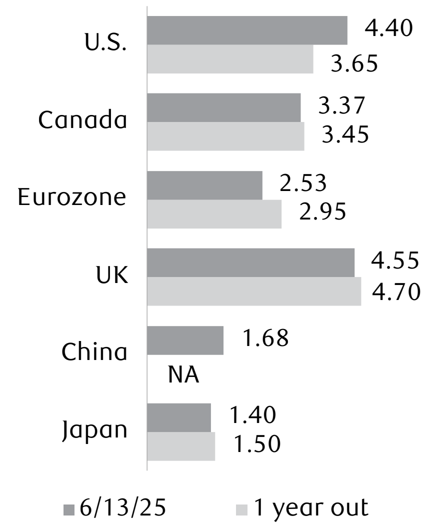
Source - Bloomberg; data through 6/13/25

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

Commodities

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Crude oil

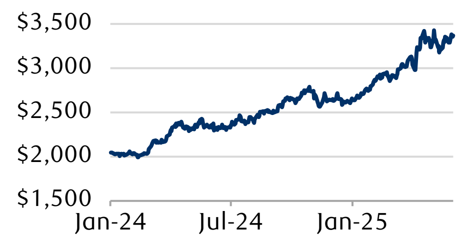
Geopolitics continues to drive this year's volatility in oil prices. Furthermore, OPEC+ continues to taper its voluntary production cuts, offset by tensions between Iran and the U.S. that have added to the supply risk. As prices ebb and flow in response to competing forces, RBC Capital Markets forecasts WTI to average US$64/bbl for 2025, falling to US$57/bbl in 2026.

Natural gas

The tone around natural gas prices centers around risk to the upside driven by LNG export and power demand. RBC Capital Markets believes the policy landscape is shifting from a hard net-zero and low-carbon agenda toward a softer stance that is more inclusive of natural gas alongside renewables, and is forecasting 2025 natural gas prices to average $4.12/MMBtu.

Gold

RBC Capital Markets is calling for higher sustained prices as the demand backdrop remains supportive in 2025. Central banks continue to be strong buyers, and global geopolitical uncertainty continues to drive fund flows into a commodity historically perceived as a less risky asset. RBC Capital Markets has taken its 2025 price target higher to $3,163/oz from $3,006/oz.



Copper

Prices are up by double digits year to date, likely driven by front loading imports ahead of expected tariffs. This has increased demand and flow of the metal into the U.S., with Commodity Exchange inventories up 90% since early March. While China, the world's largest copper importer, saw higher demand in Q1, latest indicators are pointing to a contraction. RBC Capital Markets has increased its 2025 forecast to $4.31/lb.

Soybeans

The USDA expects U.S. soybean supply for the 2025/26 marketing season to be roughly flat year over year. Globally, a record-high soybean crop is forecasted for Brazil, and China's soybean imports are expected higher as well. Bloomberg is forecasting $10.20/bu for 2025.

Wheat

The USDA forecasts global wheat production to be up 8.8 million metric tons to record levels in 2025/26. It expects China and India to produce record crops, driven by higher anticipated yields, and the European Union to have more normal yields compared to last year when wet conditions hurt the 2024/25 season. Bloomberg is forecasting a price of $5.58/bu for 2025.

Chart source - RBC Wealth Management, Bloomberg; data range 1/2/24–6/4/25

Commodity forecasts

Commodity	2025E	2026E
Oil (WTI $/bbl)	64.19	57.12
Natural gas ($/MMBtu)	4.12	3.87
Gold ($/oz)	3,163	3,489
Copper ($/lb)	4.31	4.50
Soybeans ($/bu)	10.20	10.12
Wheat ($/bu)	5.58	5.82

Source - RBC Capital Markets forecasts (oil, natural gas, gold, and copper), Bloomberg consensus forecasts (soybeans and wheat); data as of 6/5/25

Currencies

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U.S. dollar: Bearish throughout 2026

The U.S. Dollar Index (DXY) fell further in Q2 and was last seen near a three-year low. Lingering trade uncertainties from tariffs leave an unclear economic outlook in the U.S., while additional fiscal stimulus is seen as more bearish for the dollar compared to a year ago. We think USD is on a structural path lower, driven by interest rate cuts in the U.S. and an ongoing asset reallocation out of the dollar that may last until 2026, unless economic data in the U.S. improves unexpectedly.

Euro: Maintaining a target at 1.24 for year-end 2026

We expect EUR/USD to trend higher, driven by a European fiscal stimulus and a rotation of assets to Europe from U.S., with the rally potentially gaining traction once the yield differential between the U.S. and European central banks narrows significantly next year. In the short term, we may see more sideway trading on the EUR/USD pair after a 10% rally so far this year.

Canadian dollar: USD/CAD target at 1.35

RBC Capital Markets retains its long-run target on the USD/CAD at 1.35, with the risk biased closer to 1.30, depending on U.S. fiscal developments. Marginal investment in the U.S. from Canada could potentially be discouraged and put additional downward pressure on USD/CAD. The outcome of the 90-day pause on reciprocal tariffs will also be closely watched for any reassessment to the long-run target on USD/CAD.

British pound: Could benefit from carry trades

GBP/USD has rallied 8% in 2025 thus far, helped by the high relative interest rates in the UK. It could stand to gain further if markets settle into a carry-hunting mode where volatility in the currency market remains subdued. However, we expect the pound to lag the euro as the UK is fiscally constrained in its ability to support growth through deficit spending.

Japanese yen: Supported by domestic hedging activity

RBC Capital Markets maintains its view for JPY to outperform, although most of those gains may come as the Federal Reserve cuts rates further, which according to its projections, is more a story for 2026 than 2025. Japanese investors are expected 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 gap in interest rates in the U.S. and Japan narrows.

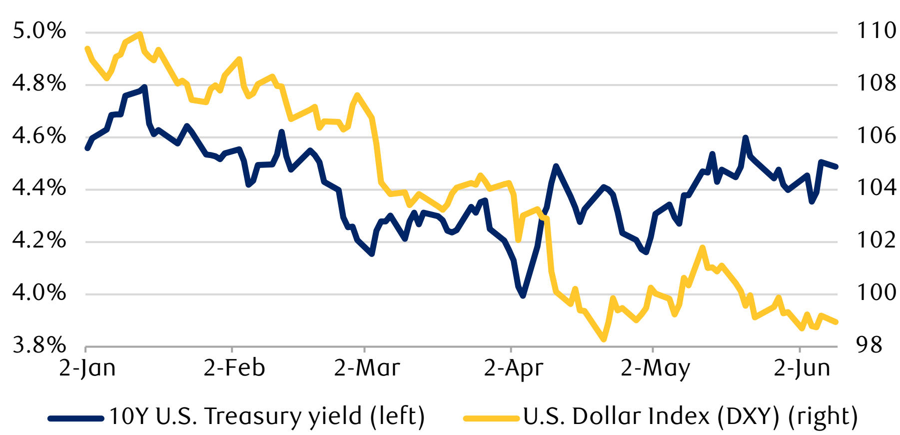
Currency forecasts

Currency pair	Current rate	Forecast June 2026	Change
Major currencies			
USD Index	100.78	93.50	-7%
CAD/USD	0.74	0.74	0%
USD/CAD	1.35	1.35	0%
EUR/USD	1.11	1.21	9%
GBP/USD	1.34	1.39	4%
USD/CHF	0.85	0.80	-6%
USD/JPY	143.63	130.0	-9%
AUD/USD	0.69	0.64	-7%
USD/NZD	0.63	0.56	-11%
EUR/JPY	159.94	157.0	-2%
EUR/GBP	0.83	0.87	5%
EUR/CHF	0.94	0.97	3%
Emerging currencies			
USD/CNY	7.02	7.40	5%

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

Source - RBC Capital Markets forecasts, Bloomberg; current rates as of 6/16/25

Tariff uncertainties and debt concerns drove the U.S. dollar lower in April despite rising Treasury yields

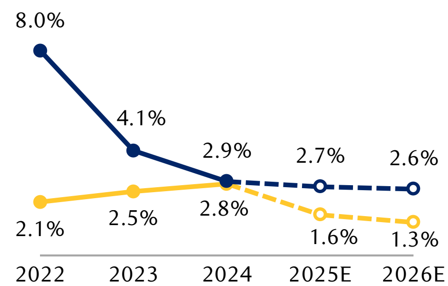


Source - RBC Wealth Management, Bloomberg; data through 6/5/25

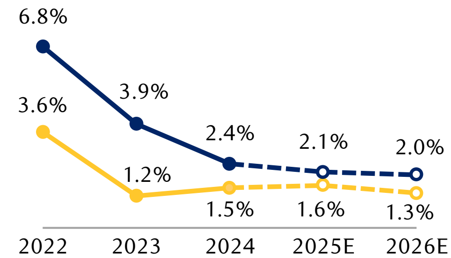
KEY

Forecasts

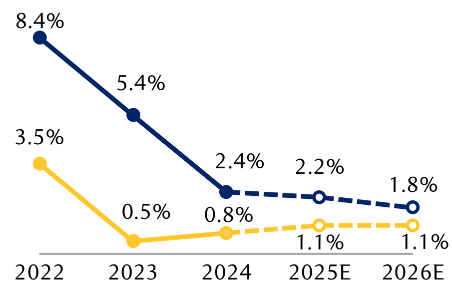
United States



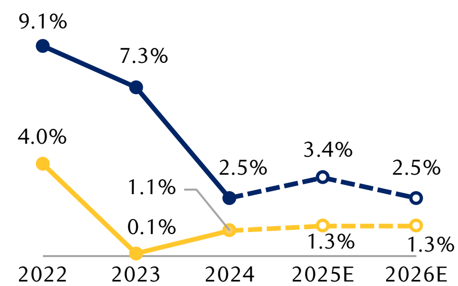
Canada



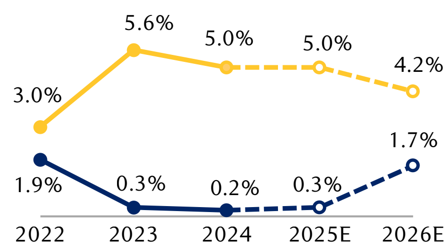
Eurozone



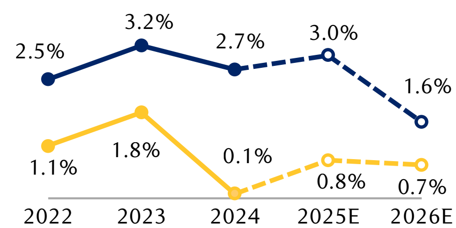
United Kingdom

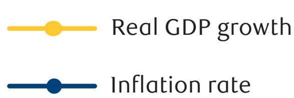


China



Japan





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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Hold [Sector Perform]	563	37.91	146	25.93
Sell [Underperform]	44	2.96	5	11.36

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