RBC Global Asset Management

Asset class commentary

NEW YEAR 2025

Global economy

It is a time of transition for the global economy. Inflation is no longer the dominant concern and central banks are now able to remove monetary restraints. When ameliorating inflation is combined with resilient economic growth, the risk of a recession in the year ahead has declined substantially.

U.S. public and foreign policy, the path of U.S. rate cuts and China's housing market represent risks to our base-case scenario.

Much will be revealed in the coming months, but we budget for a more moderate set of economic policies under Trump than those articulated on the campaign trail. The result will likely be that the U.S. economy can grow a little more quickly in the short run, that inflation runs a bit hotter (while still edging lower), and that the rest of the world lives with slightly less growth.

Fixed income

Bond yields have risen in most markets since last quarter as investors pared expectations for deep interest-rate cuts by central banks. The re-election of Donald Trump as U.S. president and Republicans' control of Congress increase policy uncertainty for the world's largest economy and bond market. At the same time, we believe the global economy is for the most part likely to continue on its pre-election path of moderating growth and near-target inflation, a path that was set in the aftermath of aggressive monetary-policy tightening. We expect that central-bank policy rates will be lower in a year's time, as both slower growth and closer-to-target inflation permit policymakers to support their economies by easing interest rates. In turn, we forecast mid-single-digit returns for bonds.

Canada

The S&P TSX Composite Index recorded total returns of 10.7% in the three months ended November 30, 2024. Lower interest rates, stronger-than-anticipated consumer spending and surging technology stocks contributed to economic growth and financial-market gains. With inflation easing, central banks in both the U.S. and Canada lowered interest rates, helping to boost equity valuations.

GDP growth is expected be 1.8% in 2025, up from 1.1% projected for 2024, driven by improved consumer spending, population growth and business investment as interest rates fall. In response to the mounting pressure on employment, housing and infrastructure, the federal government took steps to decrease immigration.

Current consensus estimates are for S&P/TSX earnings to rise 4.4% in 2024, and another 13.5% in 2025. Continued equity gains will likely depend on further monetary easing in Canada, stable commodity prices and improving economic growth.

United States

U.S. stocks, measured by the S&P 500 Index, returned 7.2% during the three months ended November 30, 2024, driven by better-than-expected earnings growth and economic optimism tied to Republican success in the November elections.

Consensus S&P 500 earnings estimates of 10% for 2024 seem reasonable but the almost 13% penciled in for 2025 is a high bar to reach unless almost everything goes right.

We believe that the rally in stocks has been supported by solid earnings growth and a belief that the potential benefits of tax relief and deregulation will outweigh the potential drags from mass deportations and tariffs. However, the S&P 500 trades at roughly 22 times the next 12 months' estimated earnings, which is the most expensive the market has been since the late 1990s. High valuations reflect a great deal of investor optimism yet risks are elevated.

Europe

While European economic growth remains anemic, financial markets in Europe are gaining due largely to improving U.S. growth and expectations that inflation moderates.

We expect labour markets to remain resilient and unemployment to stay low. We see growth improving into 2026 as easier monetary policy provides relief.

Equity valuations in Europe remain reasonable and look outright cheap compared with U.S. stocks in terms of price-to-earnings ratios and price-to-book values, helping to underpin European markets. Expectations for earnings growth in the coming year are 7% to 9%, and a further 10% gain is penciled in for 2026. This scenario supports higher valuations and presents an attractive opportunity for total shareholder returns over the year ahead.

This view is supported by an increase this year in share-buyback announcements. If this portends a sustained shift towards a more shareholder-friendly culture in Europe, the gap in total shareholder returns versus the United States could narrow.

Asia Pacific

Asian equities were broadly flat over the three-month period ended November 30, 2024, underperforming global equity markets. The Chinese stock market was among the best performing during the period, especially in September and October, as the central government undertook efforts to stimulate the economy. Japanese stocks were broadly flat as investor enthusiasm was tempered by political uncertainty after the ruling Liberal Democratic Party (LDP) lost its parliamentary majority in its worst result in over a decade.

Looking to 2025, the macroeconomic environment has become more challenging for Asian equities after the U.S. elections. Regional growth will likely fall, long-term U.S. interest rates are likely to remain higher, and Asian central banks will probably be forced to lower interest rates less aggressively than if Trump had lost. In this environment, the U.S. dollar should remain stronger given Trump's threat to impose tariffs on China and uncertainty over the tariff situation globally.

Emerging markets

Emerging-market equities have performed well so far in 2024, adding 7.7% through November 30 but underperformed developed countries. Taiwan, with a 29.4% gain, remains the standout emerging-market performer due to its large exposure to artificial intelligence. China has been the best performing country since the government announced economic stimulus in September.

The outlook for emerging markets over the next year is somewhat positive. Many emerging-market countries have healthy fiscal and trade balances and the lead that emerging-markets growth has over developed markets is expected to widen. The emerging market index has become more diversified away from China, leaving it less vulnerable to tariff tensions. However, China remains the largest market and now offers significant potential for gains as the government acts to stimulate growth and fix the property market. Lastly, emerging markets now trade at a 50% price-to-book value discount to developed markets, its largest ever discount.

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