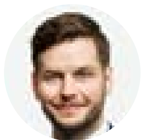
RBC Global Asset Management

Executive summary

NEW YEAR 2025



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Investors are enthused by a combination of moderating inflation, falling interest rates and Trump's election victory, which signals more U.S. growth, lower taxes and less regulation. Stocks climbed to record levels as a result. While valuation risk is mostly concentrated in U.S. large-cap growth stocks, many global equity markets still offer attractive return potential.

Economic outlook improves, helped by pro-growth U.S. administration

The economy has stabilized in recent months as inflation concerns moderate and headwinds created by higher borrowing costs fade amid interest-rate cuts. A major event risk was also resolved in the form of the U.S. election, which yielded a Republican victory in the race for the White House and Congress. While uncertainty remains as to which of President-Elect Donald Trump's ideas will be implemented, we assume that his proposed tariff and immigration policies will be significantly tempered, allowing for the effects of tax cuts, deregulation and rising animal spirits to dominate, moderately boosting the near-term U.S. growth outlook. The risk of a recession appears to have declined further and we now assign a 75% probability to a soft landing for the U.S. economy. As usual, there are a variety of risks to our base case outlook. These include uncertainty with respect to the new U.S. administration, interest-rate policy and geopolitical instability reflected by events in Ukraine and the Middle East, as well as China's housing challenges. All in all, our GDP forecasts continue to anticipate further economic growth, mostly at a moderate clip over the first half of 2025, before accelerating later in the year. Our U.S. growth outlook for 2025 has improved over the past quarter to 2.3% from 1.7%. In contrast, other developed-world forecasts are generally flat to lower, with expected growth rates slower than the U.S. For emerging markets, aggregate economic growth may slow marginally in 2025 from 2024.

Inflation likely continues cooling, though tariffs complicate the outlook

While inflation is much lower than the heights reached in 2021/2022, it isn't yet all the way back to normal and the downward path has been a bit less consistent in recent months. Additional pressures via tariffs and faster growth resulting from the new Administration's policy proposals have motivated us to raise our U.S. inflation forecast for 2025 to 2.6% from 2.3%. This forecast is slightly lower than the average rate in 2024, helped by lagged declines in shelter costs and a less dovish U.S. Federal Reserve (Fed). In other developed countries, inflation challenges are less prominent, and we have greater confidence in inflation converging toward a 2% target.

Pausing our U.S.-dollar bearish view

We've put our bearish U.S.-dollar outlook on pause following the November elections. Incoming President Trump's proposed policies on trade, taxes, deregulation and immigration are likely to be tough on U.S. trade partners and, even if these are watered down, it is likely that they would keep the Fed from cutting interest rates as much as we had previously expected. As a result, we expect the greenback to remain elevated for longer, even amid valuations that indicate dollar weakness beyond our forecast horizon. We think that the new administration's approach, as well as a more challenging European economic outlook, will pose greater headwinds for the euro while the yen, pound and Canadian dollar will be more resilient. The Chinese renminbi will also be pressured by trade tensions, though its performance depends heavily on the actions of the Chinese central bank.

Central banks to slow pace of easing

Except for the Bank of Japan (BOJ), all major developed world central banks have begun dialing back monetary restriction, including the late-arriving Fed, which delivered an initial 50-basis-point cut in September followed by a further 25-basis-point rate cut in November. Central banks are in position to ease further, but perhaps with less intensity than has been delivered so far. The combination of firmer economic data and inflation, and the fact that interest rates are no longer as restrictive means that there is less urgency for further cuts. While the Fed can likely lower its policy rate to 3.5% by the end of 2025, that figure is higher than the 2.8% endpoint priced into the futures market as recently as mid-September. Other developed economies have lower neutral rates, meaning their policy rates are capable of descending into the 2%-3% range.

Increase in bond yields boosts return potential, diminishes valuation risk

The U.S. 10-year yield fell as low as 3.60% in September and rebounded sharply to about 4.40% after the U.S. election in November. With the latest rebound in yields, we think bonds are appropriately priced in most major sovereign-bond markets except Japan, with return potential ranging from low single digits to mid single digits, and the greatest return potential being in U.S. Treasuries. Our bond model, which combines real interest rates with an inflation premium, suggests a range of 3.4% to 4.5% for the U.S. 10-year yield over the forecast horizon. These markers, we think, serve well as ranges to tactically manage fixed-income positions. We forecast the U.S. 10-year yield toward the middle of that range, namely 4.00%, over the year ahead, which would mean bond investors would get to keep their coupon and even earn a bit of capital gain.

Stocks climb to new records, though valuations are reasonable outside U.S. mega-caps

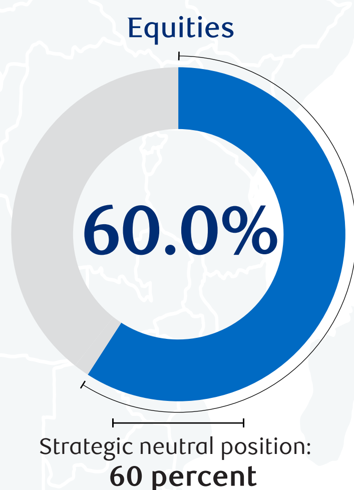
Global equities delivered impressive gains in the past year and many markets climbed to records. The strongest returns were delivered by U.S. mega-cap technology stocks, but gains began to broaden in the summer as other areas delivered strong returns. International markets underperformed, particularly after Trump's election win, given that his policy proposals favour domestic growth at the expense of international and emerging-market economies. After such a strong run in global equities, many investors may be concerned that stocks are overvalued. Our own models show that valuation excesses are concentrated in U.S. mega-cap stocks and that, outside this group of companies, equities range from fairly to attractively priced. If a re-acceleration in economic growth promotes a broad-based improvement in earnings, U.S. mid- and small-caps stocks and equities outside the U.S. could finally deliver superior returns.

Asset mix – eliminated prior underweight in bonds

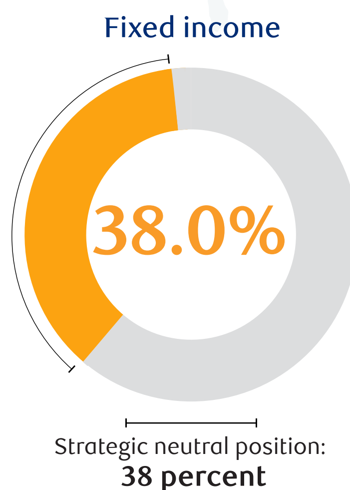
Balancing the risks and potential opportunities, our asset mix is fixed at our strategic neutral position. In our view, bonds appear to be reasonably priced and yields are likely to trade in a range over the year ahead, providing fixed-income investors with low- to mid-single-digit returns with moderate valuation risk. Stocks offer better return potential than bonds, although we are concerned that a handful of mega-cap stocks continue to make up the bulk of the weighting and returns in the U.S. market. We have been more tactical in managing our fixed-income exposure over the past several quarters. This quarter we added one percentage point to our fixed-income position as yields jumped above 4%, eliminating the underweight that was introduced in the prior quarter following the plunge in yields. Fixing our tactical asset mix at its strategic neutral position acknowledges the unusually small equity risk premium that currently exists while allowing us to take advantage of market volatility that arises. Within our neutral equity allocation, we favour regions that will benefit from a pro-growth, America-centric administration - meaning a preference for North American equities and mid- and smaller-cap stocks. For a balanced global investor, we currently recommend an asset mix of 60.0 percent equities (strategic neutral position: 60.0 percent) and 38.0 percent fixed income (strategic neutral position: 38.0 percent), with the balance in cash.

Recommended asset mix

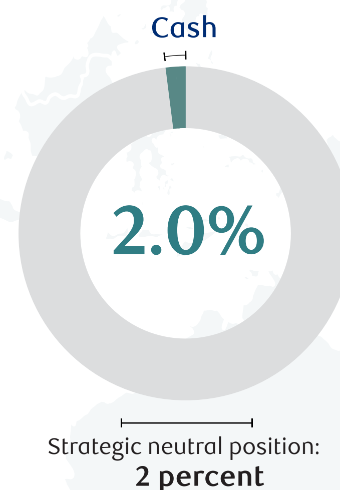
RBC GAM Investment Strategy Committee



Strategic neutral position:
60 percent



Strategic neutral position:
38 percent



Strategic neutral position:
2 percent

Note: As of November 30, 2024. Source: RBC GAM

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