RBC Global Asset Management

The Global Investment Outlook

RBC GAM Investment Strategy Committee

FALL 2021

The RBC GAM Investment Strategy Committee

Dan Chornous, CFA (chair)
Chief Investment Officer

Stephen Burke, PhD, CFA
Vice President and Portfolio Manager

Soo Boo Cheah, MBA, CFA
Senior Portfolio Manager

Dagmara Fijalkowski, MBA, CFA
Head, Fixed income and Currencies

Stu Kedwell, CFA
Co-head, Senior V.P. &
Senior portfolio manager
North-American equities

Eric Lascelles
Chief Economist

Scott Lysakowski, CFA
Vice President and Senior Portfolio Manager
Head of Canadian Equities (Vancouver)

Hanif Mamdani
Head of Alternative Investments

Sarah Riopelle, CFA
V.P. & Senior portfolio manager
Portfolio Solutions

Martin Paleczny, CFA
Vice President and
Senior Portfolio Manager

Jaco Van der Walt, DCom
Vice President and
Global Head of Quantitative Research & Investments

Milos Vukovic, CFA
V.P. & Head Investment Policy

Brad Willock, CFA
Vice President and
Senior Portfolio Manager

The RBC GAM Investment Strategy Committee consists of senior investment professionals drawn from all areas of RBC GAM. The Committee regularly receives economic and capital markets related input from internal and external sources. Important guidance is provided by the Committee's regional equity advisors (North America, Europe, Asia, Emerging Markets) and from the Global Fixed Income & Currencies sub-committee. From this, the Committee builds a detailed global investment forecast looking one year forward.

The Committee's view includes an assessment of global fiscal and monetary conditions, projected economic growth and inflation, as well as the expected course of interest rates, major currencies, corporate profits and stock prices.

From this global forecast, the RBC GAM Investment Strategy Committee develops specific guidelines that can be used to manage portfolios.

These include:

- The recommended mix of cash, fixed income instruments, and equities.
- The recommended global exposure of fixed income and equity portfolios.
- The optimal term structure for fixed income investments.
- The suggested sector and geographic make-up within equity portfolios.
- The preferred exposure to major currencies.

Results of the Committee's deliberations are published quarterly in *The Global Investment Outlook*.

Contents

2 **Executive Summary**
The Global Investment Outlook
Eric Savoie, MBA, CFA – Investment Strategist, RBC Global Asset Management Inc.
Daniel E. Chornous, CFA – Chief Investment Officer, RBC Global Asset Management Inc.

5 **Economic & Capital Markets Forecasts**
RBC GAM Investment Strategy Committee

6 **Recommended Asset Mix**
RBC GAM Investment Strategy Committee

11 **Capital Markets Performance**
Milos Vukovic, MBA, CFA – V.P. & Head of Investment Policy, RBC Global Asset Management Inc.
Aaron Ma, CFA – Senior Analyst, Investment Strategy, RBC Global Asset Management Inc.

Global Investment Outlook

15 Economic Outlook
Glide path toward normal growth
Eric Lascelles – Chief Economist, RBC Global Asset Management Inc.

32 Market Outlook
Solid fundamentals keep bull market alive
Eric Savoie, MBA, CFA – Investment Strategist, RBC Global Asset Management Inc.
Daniel E. Chornous, CFA – Chief Investment Officer, RBC Global Asset Management Inc.

50 **Global Fixed Income Markets**
Soo Boo Cheah, MBA, CFA – Senior Portfolio Manager, RBC Global Asset Management (UK) Limited
Suzanne Gaynor – V.P. & Senior Portfolio Manager, RBC Global Asset Management Inc.
Taylor Self, MBA – Associate Portfolio Manager, RBC Global Asset Management Inc.

57 **Currency Markets**
Cyclical currencies to fare best as U.S. dollar weakens
Dagmara Fijalkowski, MBA, CFA – Head, Global Fixed Income and Currencies, RBC Global Asset Management Inc.
Daniel Mitchell, CFA – Portfolio Manager, RBC Global Asset Management Inc.

Regional Equity Market Outlook

66 United States
Brad Willock, CFA – V.P. & Senior Portfolio Manager, RBC Global Asset Management Inc.

69 Canada
Sarah Neilson, CFA – Portfolio Manager, RBC Global Asset Management Inc.
Irene Fernando, CFA – Portfolio Manager, RBC Global Asset Management Inc.

72 Europe
Elma de Kuiper – Portfolio Manager, European Equities, RBC Global Asset Management (UK) Limited

75 Asia
Chris Lai – Associate Portfolio Manager, Asian Equities, RBC Investment Management (Asia) Limited

78 Emerging Markets
Philippe Langham – Head & Senior Portfolio Manager, Emerging Market Equities, RBC Global Asset Management (UK) Limited

80 **RBC GAM Investment Strategy Committee**

Executive summary

Eric Savoie, MBA, CFA
Investment Strategist
RBC Global Asset Management Inc.

Daniel E. Chornous, CFA
Chief Investment Officer
RBC Global Asset Management Inc.

The economic rebound from last year's deep recession is now behind us and some of the extreme dislocations that resulted from the pandemic are moderating. While the economy is slowing, growth remains robust and consumers are well positioned to support the expansion. Bond yields remain unsustainably low and we continue to prefer equities as surging corporate profits have pushed the bull market to new highs.

Growth downshifts as expansion progresses

The rapid spread of the delta variant is causing a rise in coronavirus infections throughout the world and challenging economies. Growth is moderating, though we should recognize that the economy was bound to slow following 16 months of extraordinary activity during which much of the slack made available from last year's recession was absorbed. We have dialed down our growth forecasts for 2022 and are now slightly below the consensus, mostly because the consensus outlook implies an optimistic outcome with no room for error. Even with our slightly less cheerful view, the pace at which the economy is expected to expand is still quite good and countries that suffered deeper recessions have the potential for even stronger growth. We forecast real GDP growth in many developed countries at nearly 4%, which is at least double the pre-pandemic norm.

Virus and other risks

The virus remains a key risk to the economy, especially with the delta variant being twice as contagious as its original form and perhaps more resistant to vaccines. As a result, more stringent measures would be needed to contain the spread even as tolerance for further lockdowns has diminished. Most governments are now turning to vaccine mandates and vaccine passports rather than forcing the lockdowns that were successful in curbing past virus waves. While it's not yet clear how effective these new measures will be at curtailing infections, they should be less harmful to the economy.

Another critical risk for the economy is the eventual shift in policy now that the economy has revived. Tremendous fiscal and monetary stimulus was delivered during the pandemic but the need for this support is less obvious and a reversal would be a headwind for growth in 2022. One factor that could offset these risks is that consumers have accumulated trillions of dollars in excess savings from the pandemic and can boost the economy through increased spending.

Inflation remains elevated, but peak may be behind

Elevated demand and constrained supply chains caused sharp price increases in a narrow set of goods and services that were popular during the pandemic. Shipping costs soared, used-car prices jumped, housing prices boomed and computer chips became difficult to source. On a broad basis, however, prices are now increasing at a normal rate in most areas of the economy, suggesting that the underlying trend to inflation is not as extreme. As a result, once distortions from the pandemic fade, we should expect headline inflation to return to rates more in line with pre-pandemic levels. We are already starting to see some price pressures easing. Commodity prices have leveled out and shipping costs may be peaking. While we recognize a diminishing threat of too-high inflation, we do consider the possibility that inflation could run above normal for a few more years. Longer term, however, inflation could be lower than normal due to structural factors such as technological advancements and aging populations.

U.S. dollar wobbles within long-term downtrend

Support from a few short-term themes helped the U.S. dollar trade sideways this year within a tight 4% band. We believe, however, that the greenback remains in a longer-term downtrend and that further weakness will persist in the years ahead. The dollar's decline should be most helpful for cyclical currencies that benefit from rising commodity prices and the global economic reopening, and we are particularly positive on currencies with central banks that will likely hike interest rates faster than the U.S. Federal Reserve (Fed). While our optimism on the euro has been tempered slightly, we remain positive on other G10 and emerging-market currencies.

Meaningful valuation risk in fixed income

Global bond yields fell significantly in the past quarter amid slowing growth and the expectation that central banks would maintain accommodative monetary policies. But according to our models, significant valuation risk exists in the sovereign-bond market and the odds, in our view, are tilted in favour of yields moving higher. Real, or after-inflation, rates of interest are deeply negative, suggesting that savers are subsidizing spenders, a situation that we don't think can persist. Although a variety of structural forces continue to depress real rates, our assessment is that real yields on U.S. 10-year Treasury bonds should be around zero or slightly above, which would represent a sizeable adjustment from current negative real rates. Further upward pressure on yields could result from the Fed and other central banks tapering their massive bond-buying programs in the coming quarters. We expect the U.S. 10-year yield to climb to 1.75% from 1.31% over our one-year forecast horizon, which would result in a slightly negative return.

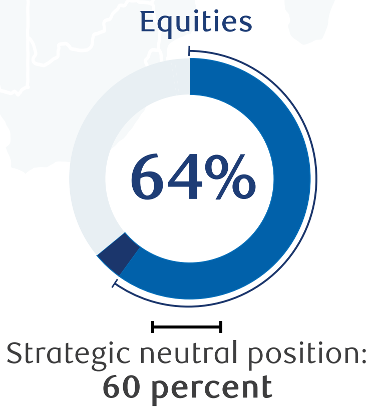
Soaring corporate profits extend bull market in stocks

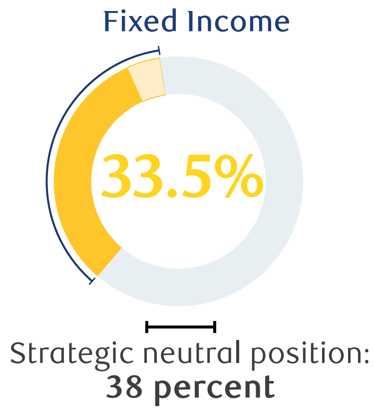
Global equities continued to march higher, rising to records on elevated investor confidence and surging profits. The S&P 500 Index climbed to an all-time high of 4500 in the past quarter, representing a doubling from its March 2020 low and a 20% gain so far this year. The rapid increase in stocks has pushed our composite of global valuations to its most expensive reading since the late 1990s technology bubble, although it remains considerably below the all-time peak. While the degree of overvaluation has been concentrated in U.S. equities for most of the latest bull market, many indexes outside the U.S. are now near or above fair value. At these valuation levels, profit gains will be critical to keeping the bull market alive and earnings have indeed been stellar so far. S&P 500 profits are on track for the most rapid recovery on record, already surpassing the pre-pandemic high, and are expected to grow at an above-average pace for the next several years. With profits having rebounded to their long-term trend, further gains may be more difficult to come by and we should not expect the pace of gains experienced so far this cycle to be repeated. Although valuations are elevated, we think stocks can still deliver modest returns given low interest rates, transitory inflation and sustained corporate-profit growth. We look for mid-single-digit gains in North American equities, with slightly better return potential elsewhere over the year ahead.

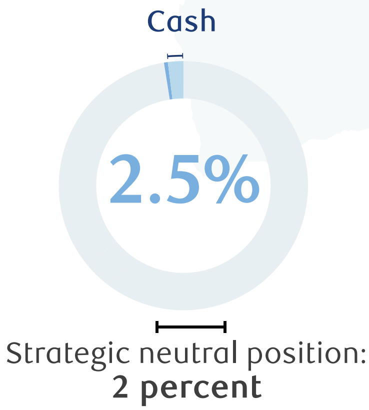
Asset Mix – trimming bond allocation in favour of cash

The economy has moderated but growth remains quite good and, in our view, the economic cycle is in its early to middle stages with several years of expansion ahead. In this environment, interest rates remain low, but central banks are contemplating reductions in their bond-buying programs before raising interest rates. As distortions from the pandemic fade, we think that bond yields are likely to gravitate higher at a gradual pace. From current levels, even a slight increase in yields would result in negative returns for sovereign bonds. As a result, we took two steps in the past quarter to further reduce our allocation to bonds, trimming our fixed-income position by one percentage point in July and another 0.5 percentage point in August, and placing the proceeds in cash. We remain overweight stocks as they offer better upside potential. We recognize, however, that valuations are demanding and that continued strong growth in profits and heightened investor confidence will be needed to keep the bull market going. For these reasons we are keeping a modest cash position to cushion against any volatility and to provide funds for opportunities as they arise. For a balanced, global investor, we currently recommend an asset mix of 64 percent equities (strategic neutral position: 60 percent) and 33.5 percent fixed income (strategic neutral position: 38 percent), with the balance in cash.

Recommended asset mix







Economic & capital markets forecasts

Economic forecast (RBC GAM Investment Strategy Committee)

	United States		Canada		Europe		United Kingdom		Japan		China		Emerging markets*	
	Fall 2021	Change from Summer 2021	Fall 2021	Change from Summer 2021	Fall 2021	Change from Summer 2021	Fall 2021	Change from Summer 2021	Fall 2021	Change from Summer 2021	Fall 2021	Change from Summer 2021	Fall 2021	Change from Summer 2021
Real GDP														
2020A	(3.40%)		(5.31%)		(6.55%)		(9.83%)		(4.74%)		2.01%		(1.40%)	
2021E	6.20%	(0.20)	6.20%	0.10	4.70%	0.10	6.70%	0.70	2.50%	(0.60)	9.00%	N/C	8.00%	N/C
2022E	3.80%	(0.30)	3.70%	N/C	3.80%	(0.80)	5.00%	(1.20)	2.60%	(0.40)	5.40%	(0.10)	5.30%	0.10
CPI														
2020A	1.25%		0.75%		0.25%		0.85%		(0.02%)		2.49%		3.37%	
2021E	4.30%	0.70	2.90%	0.10	2.20%	0.20	2.40%	0.60	0.40%	0.30	1.30%	(0.10)	3.12%	0.27
2022E	3.00%	0.30	2.40%	N/C	1.80%	0.10	2.60%	0.40	1.00%	0.20	2.50%	N/C	3.19%	0.04

A = Actual E = Estimate *GDP Weighted Average of China, India, South Korea, Brazil, Mexico and Russia.

Targets (RBC GAM Investment Strategy Committee)

	August 2021	Forecast August 2022	Change from Summer 2021	1-year total return estimate* (%)
Currency Markets against USD				
CAD (USD–CAD)	1.26	1.15	N/C	10.1
EUR (EUR–USD)	1.18	1.27	(0.03)	6.8
JPY (USD–JPY)	110.00	103.00	N/C	6.6
GBP (GBP–USD)	1.38	1.40	N/C	1.9
Fixed Income Markets				
U.S. Fed Funds Rate	0.13	0.13	N/C	N/A
U.S. 10-Year Bond	1.31	1.75	N/C	(2.7)
Canada Overnight Rate	0.25	0.25	N/C	N/A
Canada 10-Year Bond	1.22	1.50	N/C	(1.4)
Eurozone Deposit Facility Rate	(0.50)	(0.50)	N/C	N/A
Germany 10-Year Bund	(0.38)	(0.25)	N/C	(1.7)
U.K. Base Rate	0.10	0.10	N/C	N/A
U.K. 10-Year Gilt	0.71	0.80	0.10	(0.1)
Japan Overnight Call Rate	(0.04)	(0.10)	N/C	N/A
Japan 10-Year Bond	0.03	0.10	N/C	(0.7)
Equity Markets				
S&P 500	4523	4675	325	4.7
S&P/TSX Composite	20583	21200	1000	5.6
MSCI Europe	155	163	5	7.9
FTSE 100	7120	7450	75	8.7
Nikkei	28090	29700	(1000)	7.5
MSCI Emerging Markets	1309	1360	(130)	6.6

*Total returns are expressed in local currencies with the exception of MSCI Emerging Markets whose return is expressed in USD. Source: RBC GAM

Recommended asset mix

Asset mix – the allocation within portfolios to stocks, bonds and cash – should include both strategic and tactical elements. Strategic asset mix addresses the blend of the major asset classes offering the risk/return tradeoff best suited to an investor's profile. It can be considered to be the benchmark investment plan that anchors a portfolio through many business and investment cycles, independent of a near-term view of the prospects for the economy and related expectations for capital markets. Tactical asset allocation refers to fine tuning around the strategic setting in an effort to add value by taking advantage of shorter term fluctuations in markets.

Every individual has differing return expectations and tolerances for volatility, so there is no "one size fits all" strategic asset mix. Based on a 40-year study of historical returns[1] and the volatility[2] of returns (the range around the average return within which shorter-term results tend to fall), we have developed five broad profiles and assigned a benchmark strategic asset mix for each. These profiles range from very conservative through balanced to aggressive growth. It goes without saying that as investors accept increasing levels of volatility, and therefore greater risk that the actual experience will depart from the longer-term norm, the potential for returns rises. The five profiles presented below may assist investors in selecting a strategic asset mix best aligned to their investment goals.

Each quarter, the RBC GAM Investment Strategy Committee publishes a recommended asset mix based on our current view of the economy and return expectations for the major asset classes. These weights are further divided into recommended exposures to the variety of global fixed income and equity markets. Our recommendation is targeted at the Balanced profile where the benchmark (strategic neutral) setting is 60% equities, 38% fixed income, and 2% cash.

A tactical range of +/- 15% around the benchmark position allows us to raise or lower exposure to specific asset classes with a goal of tilting portfolios toward those markets that offer comparatively attractive near-term prospects.

This tactical recommendation for the Balanced profile can serve as a guide for movement within the ranges allowed for all other profiles.

The value-added of tactical strategies is, of course, dependent on the degree to which the expected scenario unfolds.

Regular reviews of portfolio weights are essential to the ultimate success of an investment plan as they ensure current exposures are aligned with levels of long-term returns and risk tolerances best suited to individual investors.

Anchoring portfolios with a suitable strategic asset mix, and placing boundaries defining the allowed range for tactical positioning, imposes discipline that can limit damage caused by swings in emotion that inevitably accompany both bull and bear markets.

[1]**Average return**: The average total return produced by the asset class over the period 1981 – 2021, based on monthly results.

[2]**Volatility**: The standard deviation of returns. Standard deviation is a statistical measure that indicates the range around the average return within which 2/3 of results will fall into, assuming a normal distribution around the long-term average.

Global Asset Mix

	Benchmark Policy	Allowable range	Fall 2020	New Year 2021	Spring 2021	Summer 2021	**Fall 2021**
Cash	**2.0%**	0.0% – 15.0%	1.0%	1.0%	1.0%	1.0%	**2.5%**
Bonds	**38.0%**	23.0% – 53.0%	37.0%	34.5%	34.5%	35.0%	**33.5%**
Stocks	**60.0%**	45.0% – 75.0%	62.0%	64.5%	64.5%	64.0%	**64.0%**

Note: Effective June 1, 2020, we reset our strategic neutral positions to reflect long-lasting changes in economy and capital markets' dynamics. Boosting strategic neutral equity exposure by 5% and reducing fixed income by same amount in our reference balanced portfolio.

Regional Allocation

Global Bonds	**WGBI* August 2021**	Allowable range	Fall 2020	New Year 2021	Spring 2021	Summer 2021	**Fall 2021**
North America	**42.2%**	32.2% – 52.2%	41.3%	41.1%	40.8%	41.7%	**39.7%**
Europe	**41.0%**	31.0% – 51.0%	36.0%	41.0%	36.9%	46.2%	**41.0%**
Asia	**16.8%**	6.8% – 26.8%	22.7%	17.8%	22.3%	12.1%	**19.3%**

Note: Past Range reflects historical allocation from Fall 2002 to present.

Global Equities	**MSCI** August 2021**	Allowable range	Fall 2020	New Year 2021	Spring 2021	Summer 2021	**Fall 2021**
North America	**68.1%**	58.1% – 78.1%	65.4%	66.0%	65.3%	65.7%	**66.8%**
Europe	**15.5%**	5.5% – 25.5%	16.2%	14.6%	15.4%	16.2%	**16.2%**
Asia	**8.1%**	0.0% – 18.1%	9.8%	10.6%	10.4%	9.4%	**8.4%**
Emerging Markets	**8.3%**	0.0% – 18.3%	8.6%	8.8%	8.9%	8.8%	**8.6%**

Our asset mix is reported as at the end of each quarter. The mix is fluid and may be adjusted within each quarter, although we do not always report on shifts as they occur. The weights in the table should be considered a snapshot of our asset mix at the date of release of the Global Investment Outlook.

Global Equity Sector Allocation

	MSCI August 2021**	RBC GAM ISC Summer 2021	**RBC GAM ISC Fall 2021**	Change from Summer 2021	Weight vs. Benchmark
Energy	2.91%	2.04%	1.41%	(0.63)	48.4%
Materials	4.40%	6.07%	2.90%	(3.17)	65.9%
Industrials	10.50%	10.65%	12.00%	1.35	114.3%
Consumer Discretionary	11.83%	14.13%	12.83%	(1.30)	108.5%
Consumer Staples	6.91%	5.55%	6.91%	1.36	100.0%
Health Care	12.72%	11.20%	13.72%	2.52	107.9%
Financials	13.54%	14.80%	13.54%	(1.26)	100.0%
Information Technology	22.57%	23.34%	23.57%	0.23	104.4%
Communication Services	9.10%	9.25%	9.10%	(0.15)	100.0%
Utilities	2.78%	0.95%	1.28%	0.33	46.0%
Real Estate	2.75%	2.03%	2.75%	0.72	100.0%

*FTSE World Government Bond Index. **MSCI World Index. Source: RBC GAM Investment Strategy Committee

At RBC GAM, we have a team dedicated to setting and reviewing the strategic asset mix for all of our multi-asset solutions. With an emphasis on consistency of returns, risk management and capital preservation, we have developed a strategic asset allocation framework for five client risk profiles that correspond to broad investor objectives and risk preferences. These five profiles range from Very Conservative through Balanced to Aggressive Growth.

Very Conservative

Asset class	Bench-mark	Range	Last quarter	Current recommendation
Cash & Cash Equivalents	2%	0-15%	1.0%	2.5%
Fixed Income	73%	68-88%	70.2%	68.7%
Total Cash & Fixed Income	75%	60-90%	71.2%	71.2%
Canadian Equities	10%	0-20%	11.4%	11.4%
U.S. Equities	8%	0-18%	8.9%	9.0%
International Equities	7%	0-17%	8.5%	8.4%
Emerging Markets	0%	0%	0.0%	0.0%
Total Equities	25%	10-40%	28.8%	28.8%

	Return	Volatility
40-year average	8.8%	5.2%
Last 12 months	4.9%	4.3%

Very Conservative investors will seek income with maximum capital preservation and the potential for modest capital growth, and be comfortable with small fluctuations in the value of their investments. This portfolio will invest primarily in fixed-income securities, and a small amount of equities, to generate income while providing some protection against inflation. Investors who fit this profile generally plan to hold their investment for the medium to long term.

Conservative

Asset class	Bench-mark	Range	Last quarter	Current recommendation
Cash & Cash Equivalents	2%	0-15%	1.0%	2.5%
Fixed Income	58%	43-83%	55.1%	53.6%
Total Cash & Fixed Income	60%	45-75%	56.1%	56.1%
Canadian Equities	13%	3-23%	14.1%	14.2%
U.S. Equities	15%	5-25%	16.0%	16.1%
International Equities	12%	2-22%	13.8%	13.6%
Emerging Markets	0%	0%	0.0%	0.0%
Total Equities	40%	25-55%	43.9%	43.9%

	Return	Volatility
40-year average	9.2%	6.3%
Last 12 months	8.8%	5.3%

Conservative investors will pursue modest income and capital growth with reasonable capital preservation, and be comfortable with moderate fluctuations in the value of their investments. The portfolio will invest primarily in fixed-income securities, with some equities, to achieve more consistent performance and provide a reasonable amount of safety. The profile is suitable for investors who plan to hold their investment over the medium to long term.

Balanced

Asset class	Bench-mark	Range	Last quarter	Current recommendation
Cash & Cash Equivalents	2%	0-15%	1.0%	2.5%
Fixed Income	38%	23-53%	35.0%	33.5%
Total Cash & Fixed Income	40%	25-55%	36.0%	36.0%
Canadian Equities	15%	5-25%	15.6%	15.8%
U.S. Equities	25%	15-35%	25.9%	26.1%
International Equities	15%	5-25%	16.8%	16.6%
Emerging Markets	5%	0-15%	5.7%	5.5%
Total Equities	60%	45-75%	64.0%	64.0%

	Return	Volatility
40-year average	9.5%	7.7%
Last 12 months	14.0%	6.6%

The **Balanced** portfolio is appropriate for investors seeking balance between long-term capital growth and capital preservation, with a secondary focus on modest income, and who are comfortable with moderate fluctuations in the value of their investments. More than half the portfolio will usually be invested in a diversified mix of Canadian, U.S. and global equities. This profile is suitable for investors who plan to hold their investment for the medium to long term.

Growth

Asset class	Bench-mark	Range	Last quarter	Current recommendation
Cash & Cash Equivalents	2%	0-15%	1.0%	2.5%
Fixed Income	23%	8-38%	19.9%	18.4%
Total Cash & Fixed Income	25%	10-40%	20.9%	20.9%
Canadian Equities	18%	8-28%	18.5%	18.7%
U.S. Equities	30%	20-40%	30.8%	31.0%
International Equities	19%	9-29%	21.0%	20.8%
Emerging Markets	8%	0-18%	8.8%	8.6%
Total Equities	75%	60-90%	79.1%	79.1%

	Return	Volatility
40-year average	9.5%	9.5%
Last 12 months	18.0%	7.8%

Investors who fit the **Growth** profile will seek long-term growth over capital preservation and regular income, and be comfortable with considerable fluctuations in the value of their investments. This portfolio primarily holds a diversified mix of Canadian, U.S. and global equities and is suitable for investors who plan to invest for the long term.

Aggressive Growth

Asset class	Bench-mark	Range	Last quarter	Current recommendation
Cash & Cash Equivalents	2%	0-15%	0.5%	0.5%
Fixed Income	0%	0-15%	0.0%	0.0%
Total Cash & Fixed Income	2%	0-17%	0.5%	0.5%
Canadian Equities	29%	19-39%	28.9%	29.0%
U.S. Equities	38%	28-48%	37.4%	37.7%
International Equities	20%	10-30%	21.5%	21.3%
Emerging Markets	11%	1-21%	11.7%	11.5%
Total Equities	98%	83-100%	99.5%	99.5%

	Return	Volatility
40-year average	9.5%	12.1%
Last 12 months	24.9%	9.7%

Aggressive Growth investors seek maximum long-term growth over capital preservation and regular income, and are comfortable with significant fluctuations in the value of their investments. The portfolio is almost entirely invested in stocks and emphasizes exposure to global equities. This investment profile is suitable only for investors with a high risk tolerance and who plan to hold their investments for the long term.

Capital markets performance

Milos Vukovic, MBA, CFA
V.P. & Head of Investment Policy
RBC Global Asset Management Inc.

Aaron Ma, CFA
Senior Analyst, Investment Strategy
RBC Global Asset Management Inc.

The U.S. dollar appreciated against all the major currencies we track in the quarter ended August 31, 2021. Worries that the pandemic recovery may be stalling and bets that the U.S. Federal Reserve may respond to higher inflation by raising rates sooner impelled investors toward the safety of the greenback over the period. The U.S. dollar strengthened 4.5% against the Canadian dollar, 3.6% against the euro, 3.3% against the British pound and 0.5% against the Japanese yen. The loonie's sensitivity to global economic growth amplified its decline during the quarter as the rapid spread of the coronavirus's delta variant threatened economic activity. The European Central Bank signaled it would keep interest rates low for longer by setting a higher bar for eventual rate hikes, hurting the value of the single currency. Sterling was similarly pressured by reduced growth expectations and monetary policy that was expected to remain extremely accommodative. The yen held up better in part due to Japan's current-account surplus. Over the one-year period, the U.S. dollar has risen 3.9% against the yen and is up 1.1% against the euro, while falling 3.3% versus the Canadian dollar and 2.8% against the pound.

Global fixed-income markets were mixed in the latest quarter in U.S.-dollar terms. Bond yields fell in major markets but the greenback's strength weighed on returns. The yield on the 10-year Treasury bond declined 29 basis points to 1.31% as the fast-spreading delta variant threatened to derail the global economic recovery. U.S. bond markets fared the best with total returns of 1.8% for the FTSE U.S. Government Bond Index and 1.6% for the Bloomberg U.S. Aggregate Bond Index. At the other end of the spectrum, the FTSE Canada Universe Bond Index and FTSE European Government Bond Index declined 2.5% and 1.6%, respectively, largely attributable to the U.S.-dollar strength against the loonie and the euro. In the past year, global fixed-income returns ranged between a loss of 3.1% for the FTSE Japanese Government Bond Index and a gain of 1.7% for the FTSE Canada Universe Bond Index, again amplified by currency movements.

Global stocks continued their advance in the three-month period as extraordinary monetary and fiscal support, soaring corporate profits and investor confidence propelled most major indexes to record highs. The S&P 500 Index led the way among broad market indexes, gaining 8.0% during the quarter in U.S.-dollar terms, and more than doubling in value since the March 2020 low. The MSCI World Index, the widely followed benchmark for global stocks, rose 5.9% to a record. Emerging-market equities did not fare as well, with the MSCI Emerging Markets Index falling 4.1% due in large part to slowing growth and rising regulatory risks in China, the index's largest constituent country. Over the one-year period, total returns were spectacular in all regions, ranging from 19.6% for the MSCI Germany Index to 33.9% for the MSCI France Index.

With economic-growth worries returning, investors favoured larger companies with more earnings certainty. Returns for U.S. large-cap stocks outstripped small-cap stocks by a wide 8 percentage-point margin during the recent quarter, with the small-cap S&P 600 Index essentially flat. Over the past year, however, the S&P 600 index outpaced the S&P 500 with a return of 54.0% - or 23 percentage points higher than the large-cap benchmark. Likewise, a preference for earnings clarity led investors toward growth stocks and away from value stocks in the latest three-month period, as the Russell 3000 Growth Index surged 13.1% versus a 1.4% gain for the Russell 3000 Value Index. Over the year ended August 31, 2021, value stocks returned 37.8%, outperforming their growth counterpart by almost 10 percentage points. The Information Technology sector, with an abundance of growth stocks, was the top performer with a 14.9% return during the three-month period, while the Energy sector lagged with a 4.6% loss. Over the one-year period, sector performance ranged from 12.9% for Consumer Staples to 46.3% for Financials.

Exchange Rates
Periods ending August 31, 2021

	Current USD	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)
USD–CAD	1.2617	4.53	(0.88)	(3.27)	(1.12)	(0.77)
USD–EUR	0.8469	3.57	3.46	1.07	(0.57)	(1.13)
USD–GBP	0.7274	3.33	(0.53)	(2.77)	(1.94)	(0.91)
USD–JPY	110.0150	0.48	6.55	3.87	(0.33)	1.24

Note: all changes above are expressed in US dollar terms

Canada
Periods ending August 31, 2021

	USD					CAD		
Fixed Income Markets: Total Return	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	3 months (%)	1 year (%)	3 years (%)
FTSE Canada Univ. Bond Index TR	(2.54)	(1.72)	1.66	5.65	3.43	1.87	(1.67)	4.47

U.S.
Periods ending August 31, 2021

	USD					CAD		
Fixed Income Markets: Total Return	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	3 months (%)	1 year (%)	3 years (%)
FTSE U.S. Government TR	1.75	(0.70)	0.04	5.55	3.17	6.36	(3.23)	4.37
BBg U.S. Agg. Bond Index TR[1]	1.63	(0.69)	(0.08)	5.43	3.11	6.24	(3.36)	4.25

Global
Periods ending August 31, 2021

	USD					CAD		
Fixed Income Markets: Total Return	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	3 months (%)	1 year (%)	3 years (%)
FTSE WGBI TR	0.13	(2.68)	(0.26)	4.53	2.51	4.66	(3.52)	3.36
FTSE European Government TR	(1.64)	(5.00)	(0.40)	4.42	2.70	2.82	(3.66)	3.25
FTSE Japanese Government TR	0.16	(5.81)	(3.07)	1.27	(1.02)	4.69	(6.25)	0.13

Canada
Periods ending August 31, 2021

	USD					CAD		
Equity Markets: Total Return	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	3 months (%)	1 year (%)	3 years (%)
S&P/TSX Composite	0.44	21.23	32.58	12.84	11.25	4.99	28.24	11.58
S&P/TSX 60	0.51	22.35	32.49	13.29	11.96	5.06	28.15	12.02
S&P/TSX Small Cap	(6.19)	17.92	42.39	10.11	7.26	(1.94)	37.73	8.88

U.S.
Periods ending August 31, 2021

	USD					CAD		
Equity Markets: Total Return	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	3 months (%)	1 year (%)	3 years (%)
S&P 500 TR	7.95	21.58	31.17	18.07	18.02	12.84	26.87	16.75
S&P 400 TR	1.25	20.30	44.77	12.18	13.74	5.84	40.03	10.93
S&P 600 TR	(0.09)	23.04	53.97	9.16	14.28	4.44	48.93	7.93
Russell 3000 Value TR	1.41	20.66	37.78	11.21	11.68	6.00	33.26	9.96
Russell 3000 Growth TR	13.11	20.08	28.81	23.71	23.80	18.23	24.59	22.33
NASDAQ Composite Index TR	11.16	18.92	30.49	24.61	25.19	16.19	26.22	23.21

Note: All rates of return presented for periods longer than 1 year are annualized. [1] Bloomberg U.S. Agg. Bond Index TR. Source: RBC GAM

Global
Periods ending August 31, 2021

	USD					CAD		
Equity Markets: Total Return	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	3 months (%)	1 year (%)	3 years (%)
MSCI World TR *	5.88	17.94	29.76	14.96	14.83	10.75	25.85	13.77
MSCI EAFE TR *	1.38	11.58	26.12	9.00	9.72	6.04	22.32	7.86
MSCI Europe TR *	1.98	15.59	29.18	9.71	10.11	6.67	25.29	8.57
MSCI Pacific TR *	0.16	4.82	20.84	7.74	9.13	4.76	17.19	6.62
MSCI UK TR *	(0.68)	14.51	27.24	3.67	5.46	3.89	23.41	2.59
MSCI France TR *	0.42	16.57	33.91	9.46	12.30	5.03	29.87	8.32
MSCI Germany TR *	(0.34)	10.69	19.63	7.40	8.58	4.24	16.02	6.29
MSCI Japan TR *	1.47	3.07	19.96	7.64	9.11	6.14	16.34	6.52
MSCI Emerging Markets TR *	(4.12)	2.84	21.12	9.87	10.40	0.28	17.47	8.72

Global Equity Sectors
Periods ending August 31, 2021

	USD					CAD		
Sector: Total Return	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	3 months (%)	1 year (%)	3 years (%)
Energy TR *	(4.60)	22.60	33.78	(8.94)	(1.79)	(0.21)	29.75	(9.89)
Materials TR *	(1.60)	14.21	31.23	13.60	13.68	2.93	27.27	12.42
Industrials TR *	1.38	15.58	32.50	11.93	12.64	6.05	28.50	10.76
Consumer Discretionary TR *	3.42	11.46	24.90	18.31	18.13	8.17	21.13	17.07
Consumer Staples TR *	1.85	7.46	12.89	9.96	7.16	6.53	9.48	8.82
Health Care TR *	9.79	17.17	23.46	14.85	13.73	14.84	19.73	13.65
Financials TR *	(0.04)	24.89	46.29	9.28	11.93	4.55	41.88	8.14
Information Technology TR *	14.95	21.61	31.11	28.36	28.98	20.23	27.16	27.03
Communication Services TR*	8.43	23.58	35.16	22.62	12.57	13.41	31.08	21.34
Utilities TR *	3.34	6.18	15.40	10.90	9.07	8.09	11.92	9.75
Real Estate TR *	7.55	23.12	29.84	10.24	7.63	12.50	25.92	9.09

* Net of taxes. Note: all rates of return presented for periods longer than 1 year are annualized. Source: Bloomberg/MSCI

Economic Outlook

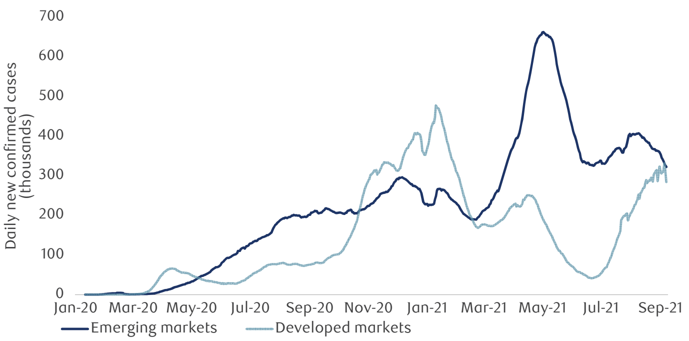
Glide path toward normal growth

Eric Lascelles
Chief Economist
RBC Global Asset Management Inc.

The economic recovery is hitting another bout of turbulence as the delta variant has again forced the COVID-19 infection rate higher (Exhibit 1). Even without this new challenge, it was inevitable that the rate of economic growth would decelerate somewhat, as the pace over the past 16 months has been remarkable and economies have already significantly eaten through their excess capacity. Our growth forecasts have been scaled back slightly for 2022, and are now moderately below the consensus.

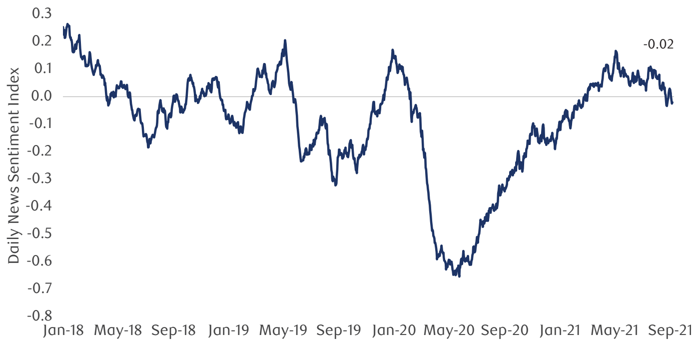
This deceleration needs to be put into context, as growth and sentiment appear set to remain quite good by any standard other than that of the prior several quarters (Exhibit 2). Countries such as the U.K. that suffered especially deep recessions appear to have the greatest room for additional strong growth.

Exhibit 1: COVID-19 infections fuelled by Delta high but waning in DM and EM countries



Note: As of 9/7/2021. Calculated as the 7-day moving average of daily infections. Source: WHO, Macrobond, RBC GAM

Exhibit 2: Daily news sentiment deteriorates as Delta wave surges



Note: As of 09/05/2021. Source: Federal Reserve Bank of San Francisco, Macrobond, RBC GAM

Exhibit 3: U.S. business cycle scorecard

	Start of cycle	Early cycle	Mid cycle	Late cycle	End of cycle	Recession
Cycle age						
Monetary policy						
Leverage						
Credit						
Bonds						
Inventories						
Economic trend						
Sentiment						
Consumer						
Employment						
Business investment						
Volatility						
Housing						
Corporate profitability						
Equities						
Economic slack						
Prices						
Allocation to each stage of cycle	11%	54%	22%	8%	1%	4%

Note: As at 2021-08-06. Darkness of shading indicates the weight given to each input for each phase of the business cycle. Source: RBC GAM

Further, our business cycle gauge argues that the cycle is still fairly young, meaning there should be several additional years of economic expansion ahead barring some unforeseen shock (Exhibit 3).

Inflation has been quite high over the past several months, creating some anxiety. While we don't expect the underlying pressures to vanish overnight and our 2022 inflation forecasts are modestly above the consensus, we do think the worst of the pandemic-recovery distortions are beginning to abate. Evidence for this view are the recent reversal in commodity prices and hints that shipping costs may be peaking.

Policymakers are again attracting close attention. In contrast to 2020, when they were delivering record-sized injections of stimulus, the year ahead is more likely to be defined by ebbing support. Central bankers are mostly looking through the high inflation, but they increasingly acknowledge the progress that has been made in the labour market. A slower pace of bond purchases will be the first step of many toward a more neutral monetary policy stance. Even as some countries announce additional fiscal initiatives, the bigger story is that government spending is set to be much less extravagant in 2022 than it has been over the past two years. In turn, some economic drag is likely from these changes.

From a financial market perspective, the most likely scenario remains for risk assets to rise further over the coming year. However, the pace may be less remarkable than over the past year, in part because the business cycle is advancing, in part because the rate of growth is decelerating, and in part because valuations are no longer cheap. From a tactical asset-allocation standpoint, we remain moderately overweight equities, and have lately reduced our exposure to fixed income modestly, shifting the proceeds to cash. Those liquid funds are available in the future for re-investment into bonds if yields become more attractive, or into equities were the stock market to slip.

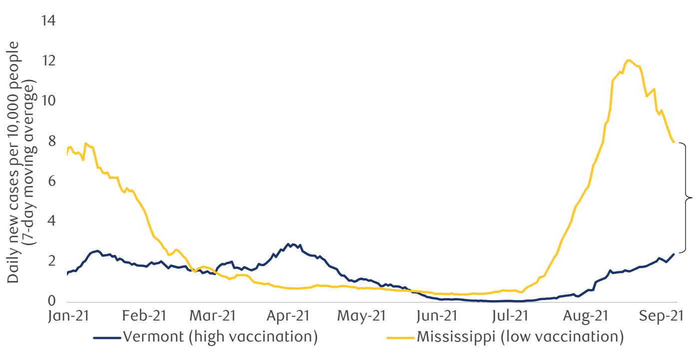
A new phase of the pandemic

Several factors have conspired to keep the pandemic going, in contrast to widespread expectations at the start of the year that COVID-19 would be all but extinguished by late summer.

The main change is that a much more contagious version of the virus emerged in the spring. The delta variant is more than twice as contagious as the original form of the virus. In turn, precautions that would have sufficed to limit the spread of the virus a year ago are insufficient today.

Another issue is that COVID-19 vaccines, while undeniably a remarkable accomplishment as evidenced by much lower infection rates in more highly vaccinated jurisdictions (Exhibit 4), have faltered. The percentage of people getting vaccinated remains well short of what is needed for herd immunity (Exhibit 5), despite ample supply in the developed world. Simultaneously, vaccines appear to be somewhat less effective against the delta variant, and their efficacy appears to decline several months after inoculation.

Exhibit 4: COVID-19 infection rates are much higher in low vaccination states



Note: As of 9/6/2021. Source: CDC, United States Census Bureau, Macrobond, RBC GAM

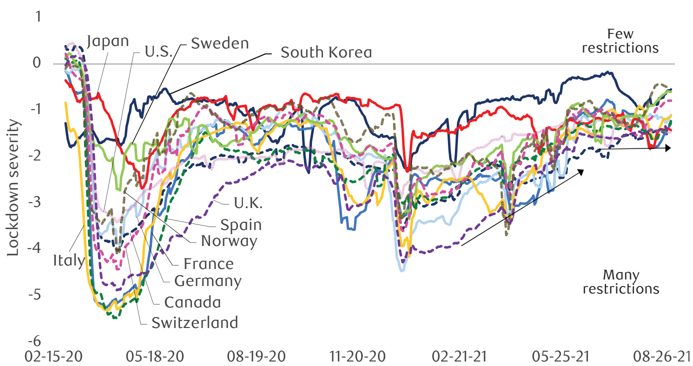
Exhibit 5: COVID-19 global vaccination ranking

Country	% of population that have received at least one dose	% of population that are fully vaccinated
U.A.E.	87.8	76.7
Spain	78.9	73.6
Canada	73.9	67.6
France	72.6	61.7
Italy	71.7	62.3
U.K.	70.8	63.8
Israel	68.4	62.7
Sweden	68.3	57.9
Bahrain	65.9	62.6
Germany	65.3	60.9
EU	65.2	59.2
Brazil	65.1	31.5
Argentina	62.2	35.8
U.S.	61.5	52.3
South Korea	59.9	35.8
Japan	59.6	48.1
Turkey	58.7	45.4
Switzerland	58.1	51.6
Poland	51.4	50.2
Australia	50.9	30.5
Mexico	45.3	27.5
India	37.9	11.5
Russia	30.5	26.3
Indonesia	24.5	14.1
South Africa	16.6	10.8

Note: Based on latest data available as of 9/6/2021. Source: Our World in Data, Macrobond, RBC GAM

Finally, the public tolerance for further lockdowns has worn thin. Most governments are no longer seriously entertaining the sort of blunt lockdowns that capped prior waves of infection, even as infections rose in recent months (Exhibit 6). Instead, many have embraced a mix of vaccine mandates and vaccine passports. A rising fraction of workers are being told to get vaccinated either by their employer or the government, and some regions are now introducing passports that restrict what unvaccinated people can access. Whether these steps will prove as effective as prior lockdowns is not yet clear, though they are certainly better for the economy.

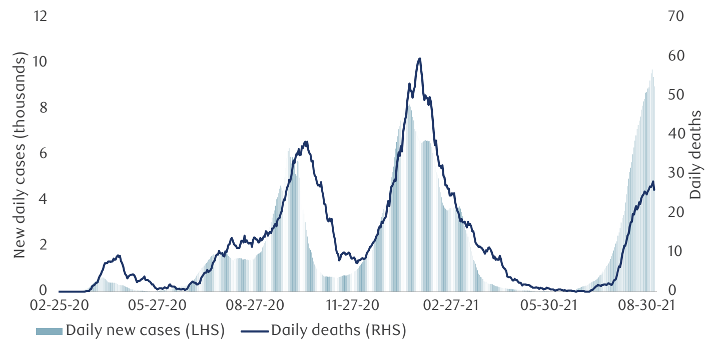
Exhibit 6: Countries switch from lockdowns to vaccine passports



Note: Based on latest data available as of 9/3/2021. Deviation from baseline, normalised to U.S.and smoothed with a 7-day moving average. Source: Google, University of Oxford, Macrobond, RBC GAM

Herd immunity for developed countries is not completely impossible given the prospect that children will become eligible for vaccination late in the year, given efforts by vaccine-makers to better target the delta variant, and given plans to administer a third shot to restore a high level of protection. Nevertheless, herd immunity is a very high bar, as more than 90% of the population has to be inoculated. Demonstrating the elusiveness of this goal, even highly-vaccinated Israel is suffering a surge of infections (Exhibit 7).

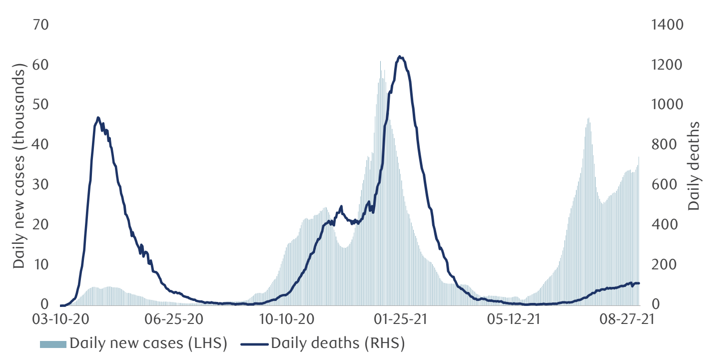
Exhibit 7: Israeli infections have surged despite high vaccination rate



Note: As of 9/6/2021. 7-day moving average of daily new cases and new deaths. Source: WHO, Macrobond, RBC GAM

In turn, COVID-19 no longer appears set to vanish any time soon. Instead, the virus may be transitioning from pandemic to endemic status. This is to say, it will continue to circulate within the population, but with less extreme consequences for the majority of those infected. Illustrating this, even as U.K. cases have been elevated in recent months, the number of hospitalizations has remained relatively tame (Exhibit 8). The U.K. has decided this is a tolerable cost in exchange for keeping its economy running and affording its population as much freedom as possible. In fact, one might even argue that these additional infections help the U.K. on its journey toward herd immunity.

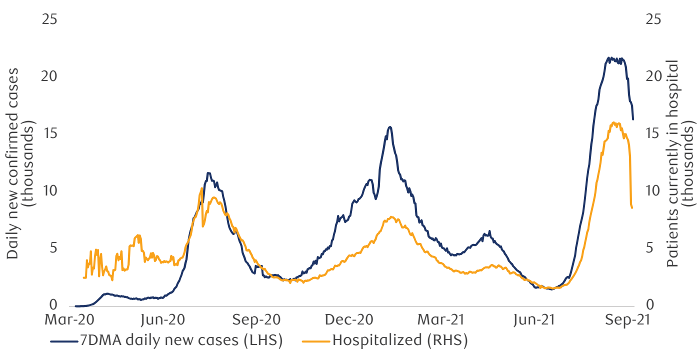
Exhibit 8: U.K. tolerates high infections because vaccines keep deaths low



Note: As of 9/7/2021. 7-day moving average of daily new cases and new deaths. Source: WHO, Macrobond, RBC GAM

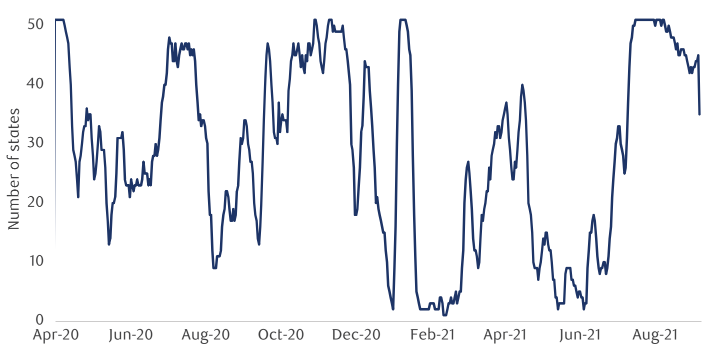
There are exceptions to this narrative. In the U.S., hospitalizations have also jumped, unlike in most other countries, setting records in several southern states (Exhibit 9). While the U.S. vaccination rate is lower than in many other developed countries, the difference isn't sufficiently large to entirely explain why the U.S. has so many more severe cases. Fortunately, there is a second U.S. surprise, this one happy: U.S. infections are seemingly starting to peak in much parts of the country (Exhibit 10). It could be that enough Americans have been infected via natural means that the U.S. is closer to herd immunity than conventionally thought (Exhibit 11).

Exhibit 9: High Florida cases and hospitalizations now declining



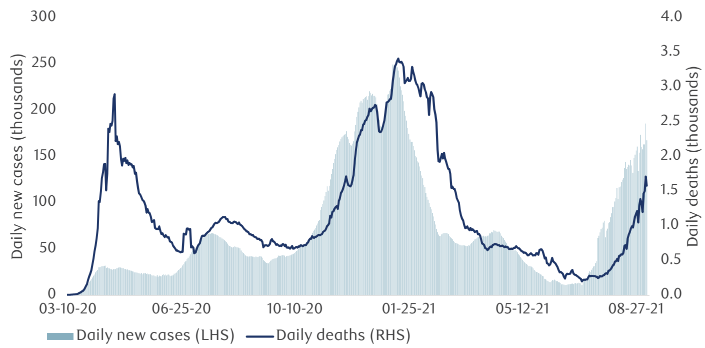
Note: As of 9/6/2021. Hospitalization data before 7/10/2020 from HHS. Source: CDC, Department of Health & Human Services, Macrobond, RBC GAM

Exhibit 10: Fewer U.S. states have rising infection numbers



Note: As of 9/7/2021. Transmission rate calculated as 7-day change of underlying 5-day moving average of new daily cases, smoothed with 7-day moving average. Transmission rate above 1 suggests increasing new daily cases. Includes Washington, D.C. Source: Haver Analytics, Macrobond, RBC GAM

Exhibit 11: Delta variant drives U.S. infection surge, but possibly peaking



Note: As of 9/6/2021. 7-day moving average of daily new cases and new deaths. Source: WHO, Macrobond, RBC GAM

Surprisingly, many emerging-market nations have also begun to record declining numbers of new infections, even though most are only now beginning to vaccinate a significant fraction of their population. They may, in fact, be close to herd immunity due to widespread (underreported) infections.

Of course, the combination of colder weather in the Northern Hemisphere's fall and the return to physical schooling could render premature the hypothesis that the delta variant is peaking.

Zero-tolerance countries such as China, Australia and New Zealand, which have endeavored to keep their COVID-19 infection rates at zero, have fared admirably across most of the pandemic. They have permitted their citizens a nearly normal life most of the time, while imposing occasional fierce lockdowns to drive the case count down to zero when the virus escapes quarantine. However, it is unclear whether this approach is compatible with the delta variant. The new variant is so contagious that it may be folly to try to completely halt its spread. In turn, these countries could end up being pitied rather than envied if their citizens are forced into never-ending harsh lockdowns. This worry is of greatest economic relevance with regard to China, which recently shut down part of a major port in response to an outbreak, potentially damaging the global economy at a fragile moment.

Whatever the exceptions, the main story is still one in which the latest wave of infections should not do as much economic damage as previous ones. There should be fewer deaths, countries are less likely to fully lock down and businesses have gotten better at conducting their affairs when restrictions are imposed.

Slowing growth

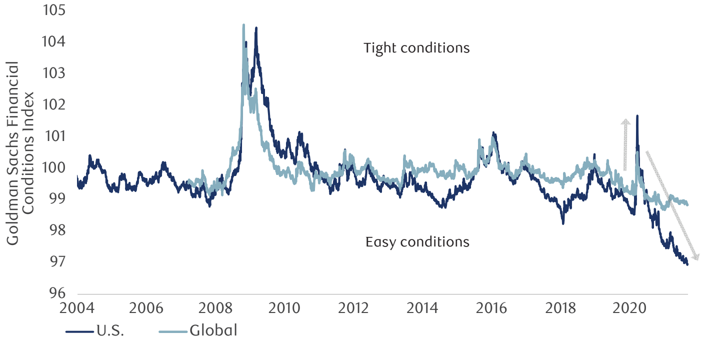
Economic growth remains quite fast by any standard other than the searing clip that was maintained between the middle of 2020 and the middle of 2021.

There are still several highly supportive factors. Global financial conditions are extraordinarily stimulative, even as central banks start to muse about withdrawing support (Exhibit 12). Household finances remain excellent, with low financial-obligation ratios (thanks largely to low borrowing costs) and high savings rates that provide a welcome buffer against any economic or financial-market turbulence. There is also some remaining space for catch-up growth before economies are back to their full potential (Exhibit 13).

That said, some of the pent-up demand that drove the U.S. economy forward as restrictions were lifted is beginning to abate, as evidenced by hotel-occupancy rates that appear to have peaked (Exhibit 14). The delta variant's surge is visible in some of the figures, such as a recent reversal in what had been a trend of rising office occupancy (Exhibit 15). Monetary and fiscal policy should also become less supportive over the coming year.

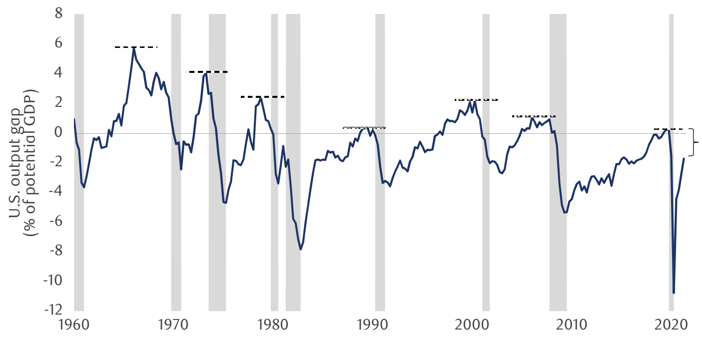
From a top-down perspective, purchasing manager indexes show some deceleration from the first half to the second half of the year (Exhibit 16) and our real-time economic activity index has similarly ceased to ascend quite so keenly (Exhibit 17).

Exhibit 12: Financial conditions still extremely stimulative



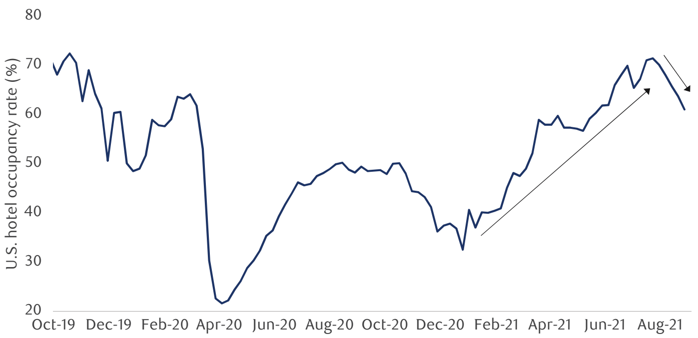
Note: As of 9/3/2021. Source: Goldman Sachs, Bloomberg, RBC GAM

Exhibit 13: There's still room for catch-up growth in coming year



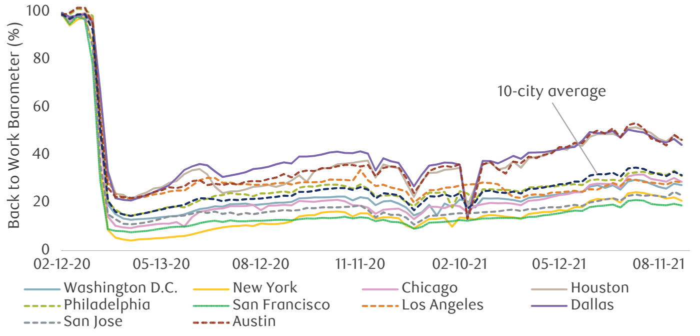
Note: As of Q2 2021. Shaded area represents recession. Source: CBO, Macrobond, RBC GAM

Exhibit 14: U.S. hotel occupancy declined on Delta surge



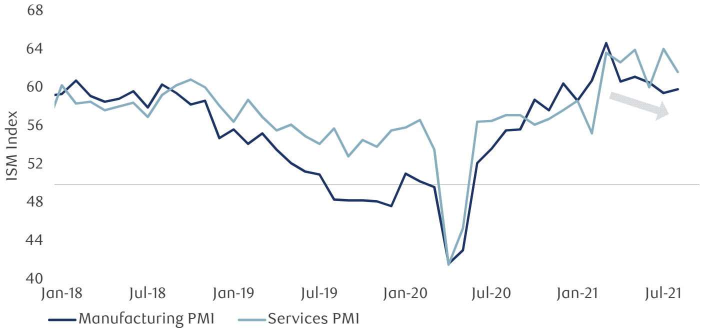
Note: For the week ending 8/28/2021. Source: STR, Wall Street Journal, RBC GAM

Exhibit 15: Office occupancy in U.S. remains low; now falling with Delta



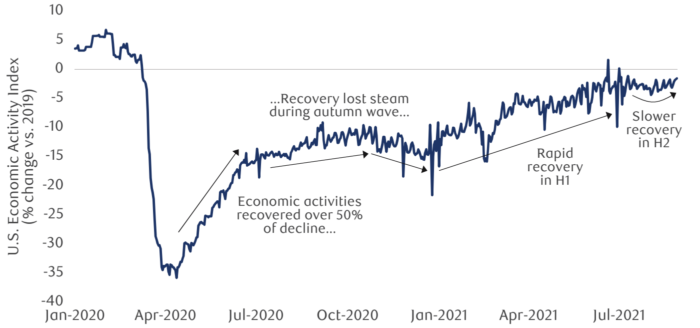
Note: As of the week ending 9/1/2021. The Barometer represents the weekly office occupancy based on swipes of access controls. Source: Kastle Systems, Bloomberg, RBC GAM

Exhibit 16: U.S. leading economic indicators edge lower



Note: As of Aug 2021. Source: ISM, Haver Analytics, RBC GAM

Exhibit 17: U.S. economic activity now rising less eagerly



Note: As of 08/28/2021. Economic Activity Index is the average of nine high-frequency economic data series measuring the percentage change versus the same period in 2019. Source: Bank of America, Goldman Sachs, OpenTable, Macrobond, RBC GAM

Below-consensus outlook

With 2021 now nearly three-quarters complete, the forecasting focus has shifted toward 2022. Consistent with the pattern of decelerating growth, we look for a somewhat slower rate of expansion next year versus this year (Exhibit 18). Even so, growth is forecast at nearly 4% in many developed countries – at least double the pre-pandemic norm.

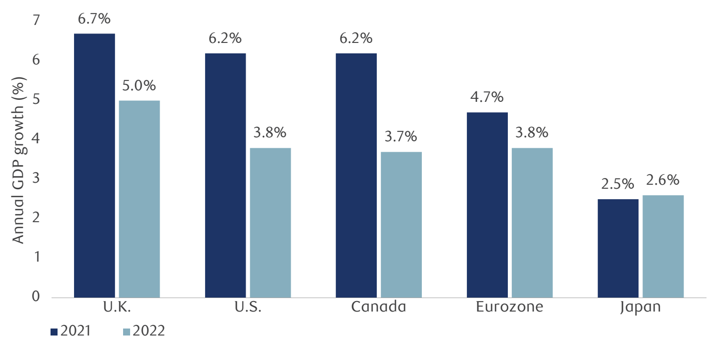
Key among the considerations supporting this decelerating forecast, we expect the U.S. economy to have returned to its full potential by early next year (Exhibit 19), with other developed countries set to do so at varying points over 2022. This limits the capacity for further outsized gains.

> "Economic surprises have retreated significantly, to the point that below-consensus bets are now more likely than not to pay off."

Our forecasts are moderately below the consensus, largely because the optimism implied by the consensus leaves little room for anything less than perfection. There are arguably more negative than positive risks out there, as discussed later. We also note that economic surprises have retreated significantly, to the point that below-consensus bets are now more likely than not to pay off (Exhibit 20).

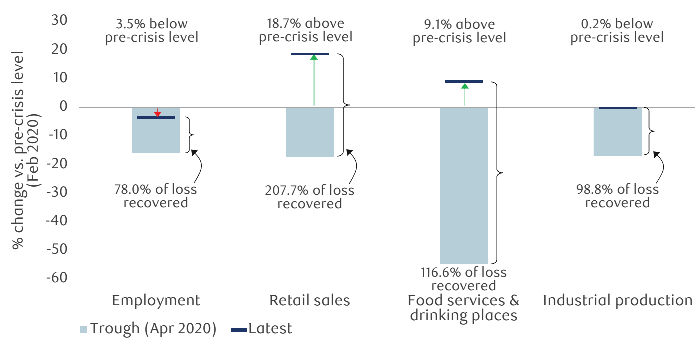
Our economic outlook is broadly the same for emerging markets, with mostly below-consensus forecasts for 2022 (Exhibit 21). Chinese growth should fall to 5.4% as its zero-tolerance approach to COVID-19 strains its economy. India should do better, with room to knock out an 8.3% gain after a challenging pandemic, and we also remain optimistic about the country's long-run prospects. Many emerging-market nations are now enjoying a declining rate of COVID-19 infection – a positive for their economies (Exhibit 22).

Exhibit 18: RBC GAM GDP forecast for developed markets



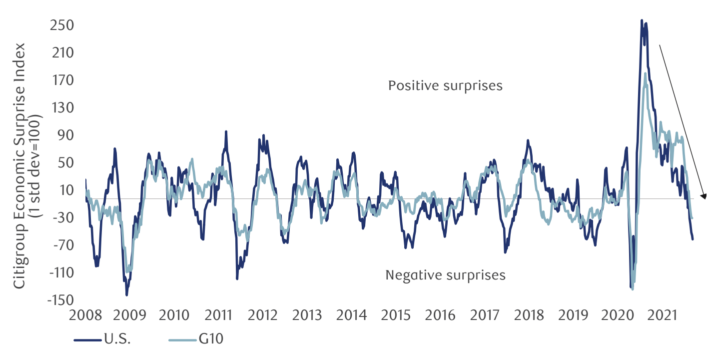
Note: As of 08/06/2021. Source: RBC GAM

Exhibit 19: Significant U.S. recovery has already taken place



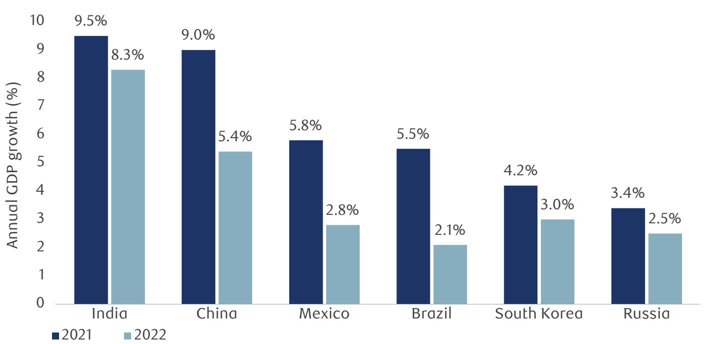
Note: Employment as of Aug 2021; retail sales, food services & drinking places, and industrial production as of Jul 2021. Trough since Feb 2020. Source: Macrobond, RBC GAM

Exhibit 20: Global economic surprises plunged into negative territory



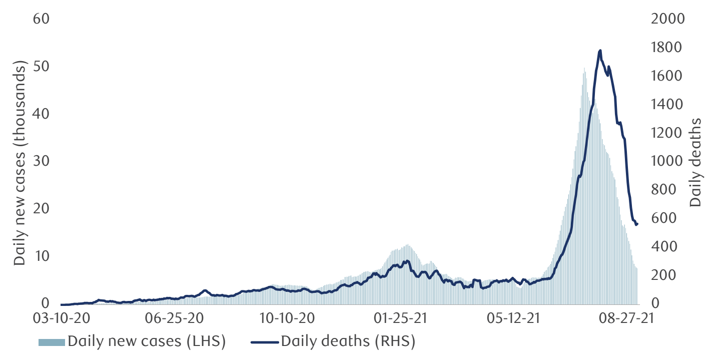
Note: As of 9/7/2021. Source: Citigroup, Bloomberg, RBC GAM

Exhibit 21: RBC GAM GDP forecast for emerging markets



Note: As of 8/6/2021. Source: RBC GAM

Exhibit 22: Indonesia once hit hard by the Delta wave, now recovering



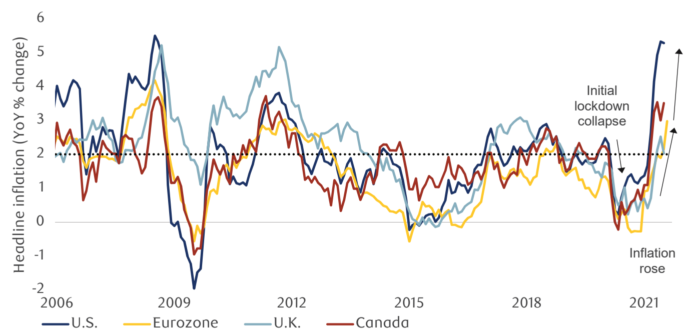
Note: As of 9/6/2021. 7-day moving average of daily new cases and new deaths. Source: WHO, Macrobond, RBC GAM

Inflation peaking?

Inflation has risen sharply (Exhibit 23) – an unfamiliar development after several decades of low and falling inflation. The stakes are high: not only does inflation determine the rate at which the purchasing power of money erodes, but it is a key catalyst for the level of interest rates and, by extension, valuations for other asset classes.

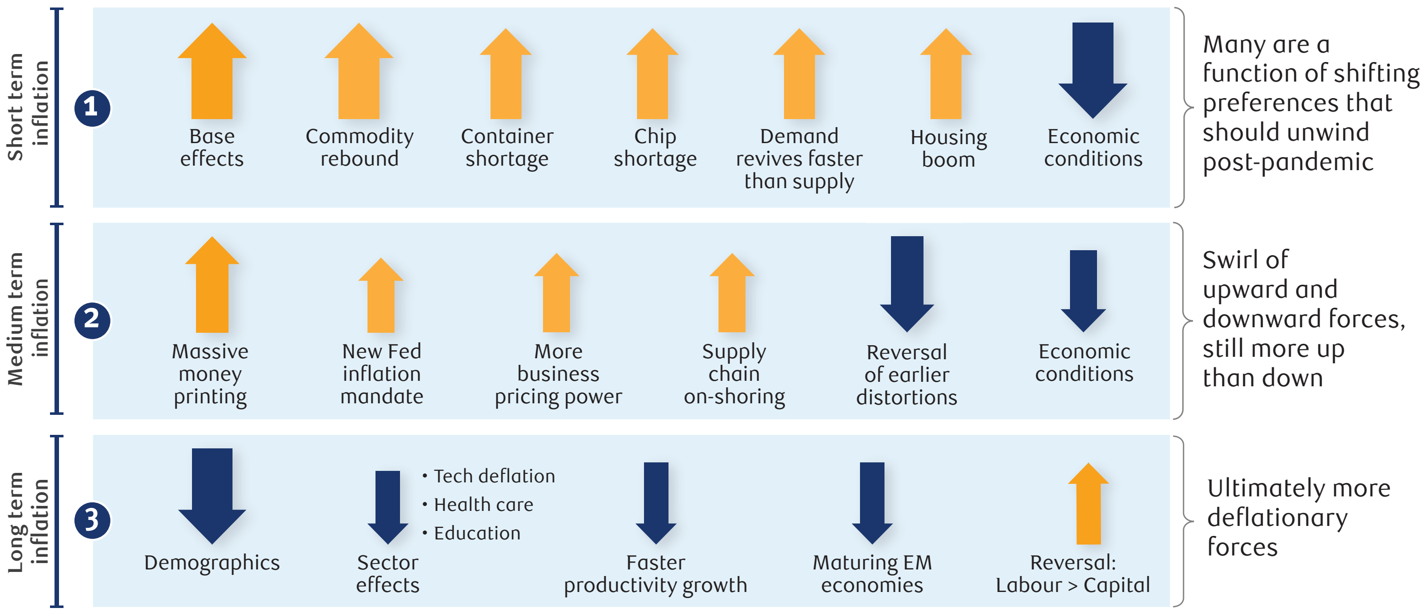
It is not a surprise that inflation is elevated given booming economic growth and the arrival of several pandemic-era developments (Exhibit 24). These include a significant rebound in commodity prices, a container shortage that has raised shipping costs, a shortage of computer chips and a housing boom. These developments are due largely to changes in what people have bought during the pandemic. More recently, as some of these distortions have begun to unwind, there has been a surge of demand for the products produced by previously restricted sectors, creating backlogs there.

Exhibit 23: Inflation has risen in major economies



Note: Canada, U.K., and U.S. as of Jul 2021, Eurozone as of Aug 2021. Source: Bureau of Labor Statistics, Office for National Statistics, Statistics Canada, Statistical Office of the European Communities, Haver Analytics, RBC GAM

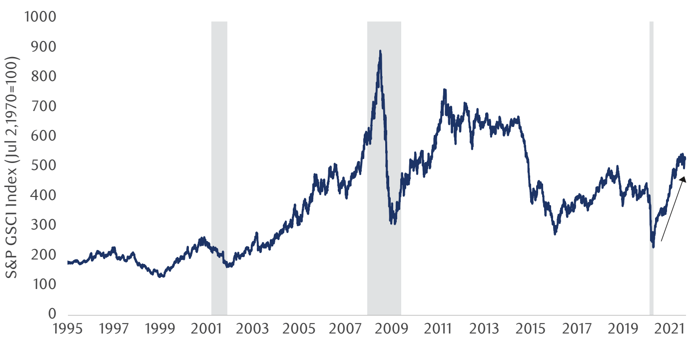
Exhibit 24: Inflation to be quite high in short term, a little high in medium term, normal to low in long term



Note: As of 8/6/2021. Source: RBC GAM

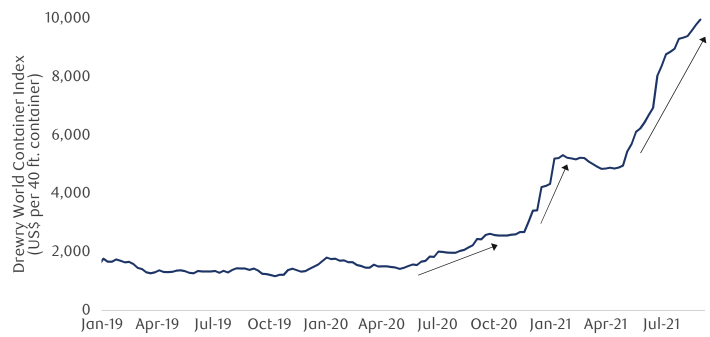
Fortunately, some of these problems are beginning to fade. Commodity prices have leveled out (Exhibit 25), and shipping costs, while still extremely elevated, may be starting to peak (Exhibit 26).

Exhibit 25: Commodities rallied on reopening, but have slipped from recent peak



Note: As of 9/7/2021. Shaded area represents recession. Source: S&P, Haver Analytics, RBC GAM

Exhibit 26: Shipping costs soared during the pandemic



Note: As of the week ended 09/02/2021. Source: Drewry Supply Chain Advisors, RBC GAM

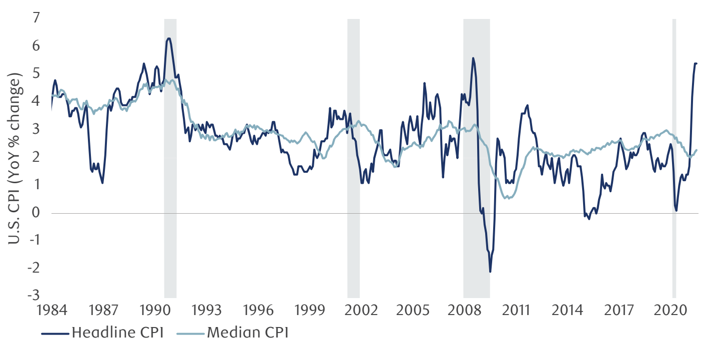
Reflecting the unusual nature of the inflation spike, price pressures are quite narrowly based. The median inflation rate in the U.S. – based on the rate at which half the components of the inflation basket are higher and half are lower – is far tamer than the headline figure (Exhibit 27). Not only does this dispel the notion that high inflation is due to an overheating economy or central-bank money-printing (both of which would increase inflation broadly), it also means that prices for most products are rising at a relatively normal rate, and, furthermore, that we should expect much more normal inflation once extreme distortions in such categories as used-car prices abate.

While there are anecdotes of large wage increases, in practice there is little evidence of a sudden spike in salaries (Exhibit 28).

All of this said, we do not expect this bout of elevated inflation to disappear overnight. Businesses continue to indicate that they plan to pass cost increases on to their customers to an extent not seen in decades (Exhibit 29), and chip shortages will not soon be resolved.

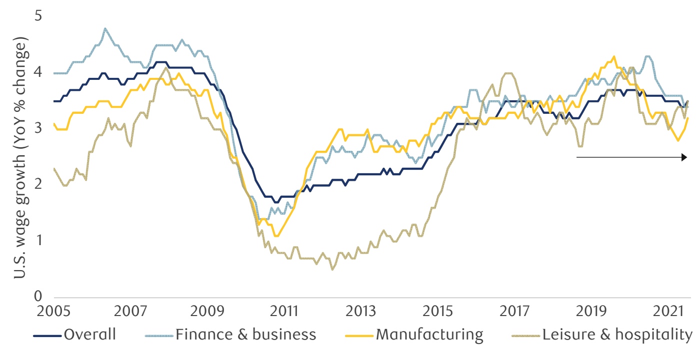
Our inflation forecast anticipates diminishing pressures in 2022, but nevertheless an above-consensus outlook (Exhibit 30). Even as short-term pressures fall, a number of medium-term pressures may keep inflation from fully normalizing

Exhibit 27: U.S. overall inflation jumps but median inflation remains tame



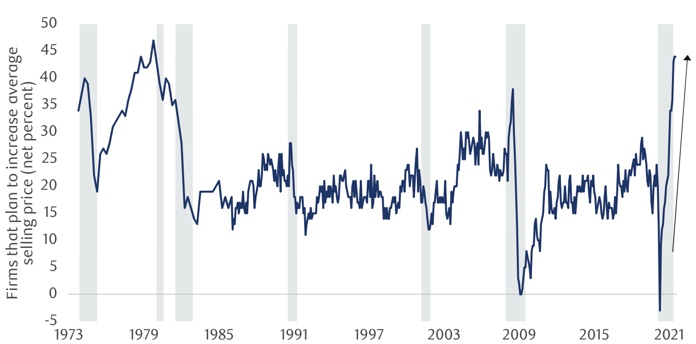
Note: As of Jul 2021. Shaded area represents recession. Source: BLS, Federal Reserve Bank of Cleveland, Macrobond, RBC GAM

Exhibit 28: Wage growth has been fairly stable despite anecdotes to the contrary



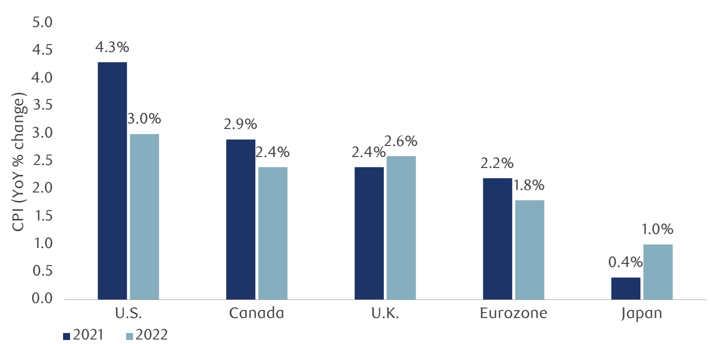
Note: As of Jul 2021. 12-month moving average of median wage growth. Source: Federal Reserve Bank of Atlanta, Haver Analytics, RBC GAM

Exhibit 29: U.S. businesses are planning to raise prices – highest since early 1980s



Note: As of Jul 2021. Shaded area represents recession. Source: NFIB Small Business Economic Survey, Haver Analytics, RBC GAM

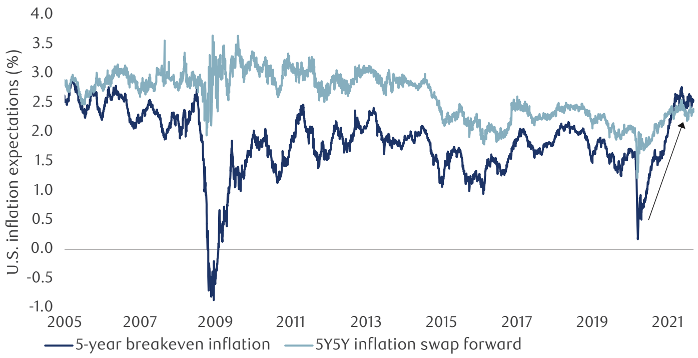
Exhibit 30: RBC GAM CPI forecast for developed markets



Note: As of 8/6/2021. Source: RBC GAM

for a few more years. But, with relevance to the long run, we see little evidence that inflation expectations are becoming unmoored (Exhibit 31), and there is even a chance that inflation could be lower than normal as the population ages.

Exhibit 31: U.S. inflation expectations stabilize and still calm about long term



Note: As of 9/7/2021. Source: Bloomberg, RBC GAM

Pivoting on public policy

The delivery of unprecedented fiscal and monetary stimulus was central in avoiding an even deeper economic depression during the worst of the pandemic. As economies have revived, the need for this support has ebbed somewhat.

This tentative reversal is an important theme, as it constitutes a headwind for economic growth in 2022.

On the fiscal side, governments spent remarkable sums of money in 2020 and 2021. This trend isn't quite over. The U.S. is working toward a multi-trillion-dollar infrastructure package, Europe's recovery fund is gaining steam and Canada introduced additional economic support in a recent budget, with further promises being made during the country's election campaign.

Nevertheless, the net impact of this support for 2022 and beyond should be considerably less than it was over the past two years. The effect of the U.S. infrastructure package is significantly undermined by a simultaneous increase in taxation, and the spending is scheduled to be spread out over a decade. Further, fiscal outlays only boost economic growth when they outpace the prior year's effort. Because of

this, there is likely to be a fiscal drag in 2022 as governments propose to spend much less than over the prior few years (Exhibit 32).

On the monetary side, central banks are beginning to inch away from maximum stimulus delivery. The Bank of Korea has already increased its policy rate, while the Bank of Canada and a number of other central banks have begun to scale back the pace of their bond purchases. The U.S. Federal Reserve is hinting that it may do the same toward the end of 2021.

Rate increases are still at least a year away for most developed-world central banks, but a gradual pivot is underway (Exhibit 33). In turn, it would make sense for borrowing costs to increase modestly over the next few years, and consequently for the economies to experience somewhat slower growth.

The bond market has not expressed any serious concern about the prospect of a gradual withdrawal of monetary stimulus, though there is always the risk of a taper tantrum. Fortunately, the monetary approach has been somewhat different than it was after the global financial crisis: central banks have behaved more cautiously, have clearly separated tapering from rate increases, and are waiting longer before beginning the normalization journey.

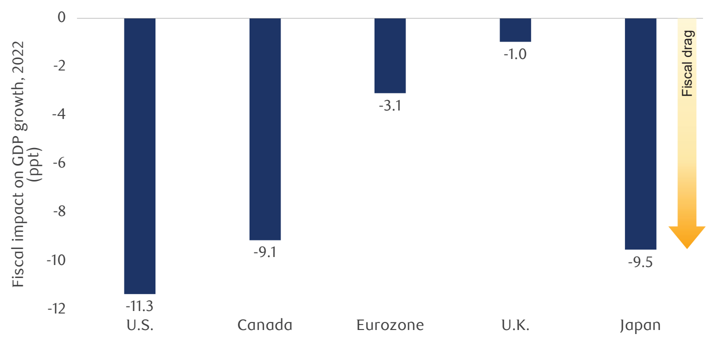
Furthermore, policymakers can be nimble if needed. For instance, China has pivoted back into monetary stimulus mode after its economy recently underperformed. While the most likely scenario is gradually tightening monetary policy for the developed world, any unexpected economic headwinds can still be dealt with.

A range of risks

Inevitably, there are a variety of risks that – if triggered – could take the economic trajectory above or below our base-case outlook (Exhibit 34).

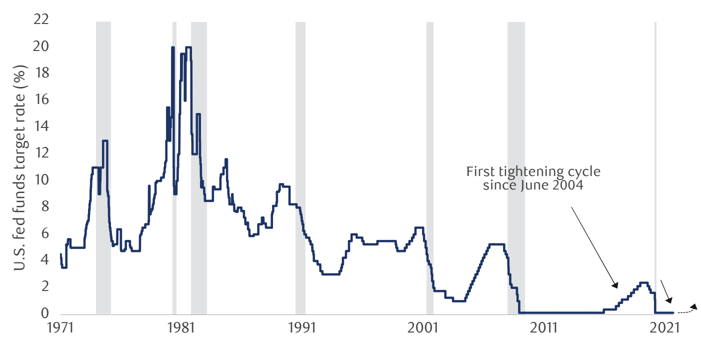
Overall, we judge the downside risks to be somewhat greater than the upside ones. This hardly guarantees that the economy will underperform our base-case forecast – the base-case still constitutes our best estimate – but it does make us incrementally more comfortable with the fact that our forecasts are positioned below the consensus.

Exhibit 32: Theoretical fiscal drag for developed countries in 2022



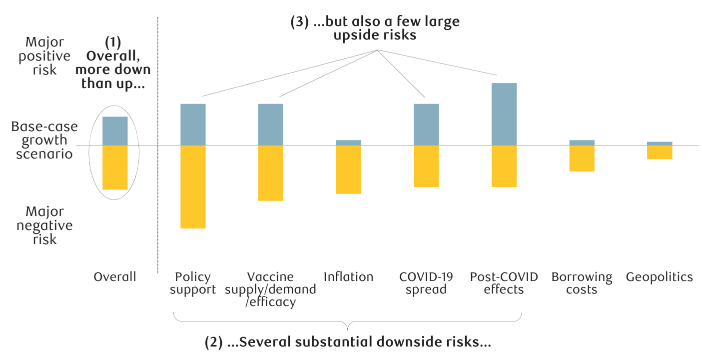
Note: RBC GAM estimates as of 7/28/2021 based on IMF and OECD forecast of fiscal balance. Source: Macrobond, RBC GAM

Exhibit 33: U.S. fed funds rate low but to edge higher over next few years



Note: As of 9/7/2021. Shaded area represents recession. Source: Federal Reserve Board, Macrobond, RBC GAM

Exhibit 34: Key global macro risks over the next year



Note: As of 07/29/2021. Size of each bar reflects probability-weighted impact of bull-case/bear-case scenario. Source: RBC GAM

A particularly large risk relates to the uncertain outlook for public policy. This might initially seem surprising. After all, we have a reasonably good sense of what central banks and fiscal policymakers plan to do over the coming year. However, there is a real chance that additional fiscal stimulus will be delivered over the coming year – politicians have been unable to resist returning to the fiscal well several times over the pandemic, even as the economic need has abated. Conversely, the negative public policy risk is even larger. This isn't because fiscal policy might become much stingier. Instead it is because the economy could encounter more indigestion than we have budgeted for as fiscal stimulus and monetary stimulus ebb.

Another key risk relates to vaccines. On the positive side, the supply of vaccines could continue to accelerate, vaccine mandates and passports may encourage more people to get inoculated, vaccines may be created to better target the delta variant, and boosters could extend the duration of protection. On the negative side, another new variant could emerge, sharply diminishing vaccine efficacy and reversing a year's worth of scientific and logistical effort.

A third risk worth mentioning relates to post-COVID-19 effects. Any number of major trends could reveal themselves once the worst of the pandemic is over. On the optimistic side, households might unleash their trillions of dollars in excess savings or the pandemic experience could stir major productivity gains. Pessimistically, households and businesses, traumatized by the pandemic, might instead behave cautiously for years to come. The decline in labour-force participation could also prove enduring and a retreat from corporate offices could subtly damage productivity.

Variation by country

Most countries have had a broadly similar COVID-19 economic experience since the beginning of 2020 – a sharp decline early in that year followed by a recovery that has ebbed and flowed well into 2021. However, the extent of this recovery has varied somewhat by country.

Looking forward, the most important growth differentiator between nations is the extent to which each country has room to "catch up" to normal. A nation like the U.S., which should reach its full economic potential around the end of this year, has less theoretical room for rapid growth in 2022 than a country whose economy severely underperformed earlier in the pandemic, like the U.K. This is reflected in our forecasts, with the U.S. set to grow by 3.8% in 2022, versus the U.K. at 5.0%.

But other factors must also be weighed. Japan has a much lower potential growth rate than most other countries, so its growth is also relatively more restricted in 2022 (a 2.6% forecast). This consideration also limits the rate of Eurozone growth in 2022 (a 3.8% forecast, despite more economic slack remaining to be eaten through than the U.S.).

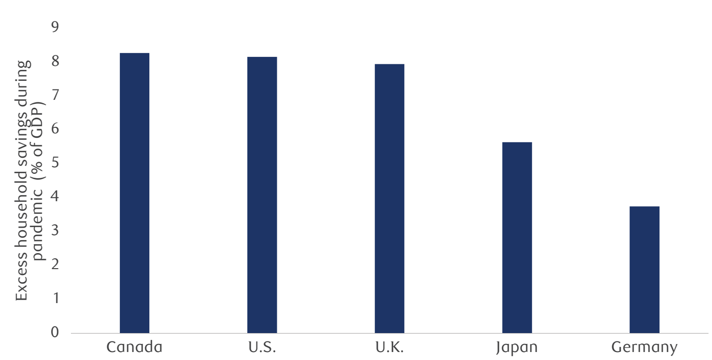
Households around the world have saved more money during the pandemic, with the U.S. and Canada saving the most as a fraction of GDP (Exhibit 35). Should any of this be unleashed, it will favour those nations.

Mixed Canadian considerations

Canada has performed fairly well through the pandemic. The initial economic damage was not as deep as it was in the U.K. and the Eurozone, and the Canadian government doled out generous economic support. Canada has recorded considerably fewer COVID-19 cases on a population-adjusted basis than the U.S., and Canada has also been among the most effective countries at getting its population vaccinated.

Traditional economic indicators show that there remains some work to be done before Canada returns to its full economic potential, but significant progress has already occurred (Exhibit 36).

Exhibit 35: Considerable excess household savings due to pandemic



Note: As of June 2021 for Canada, Germany and U.S.; March 2021 for Japan and U.K.. Source: Macrobond, RBC GAM

The immediate future is clouded by an increased number of COVID-19 cases in Canada, propelled by the delta variant (Exhibit 37). Although the Canadian economy recently registered a surprisingly poor performance in July, we don't believe it reflects a sinister new trend. To the contrary, real-time economic indicators remain fairly good (Exhibit 38).

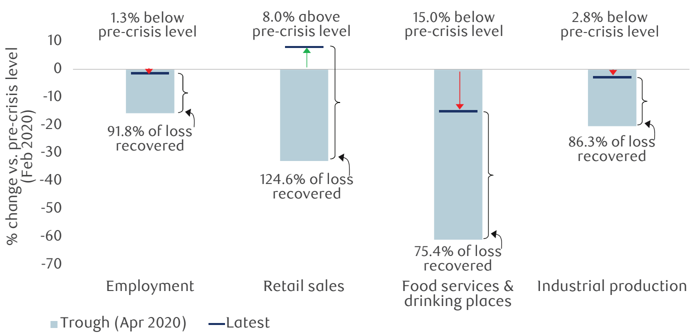
Canadian policymakers are increasingly embracing vaccine mandates and vaccine passports, meaning that blunter economic restrictions are less likely to be deployed (Exhibit 39). This approach should keep the economy from decelerating too badly through the latest wave of infections. We anticipate 3.7% growth for Canada in 2022 – nearly double its normal speed limit, and in line with the U.S.

The rebound in commodity prices has been useful for Canada's resource sector, with the increase in oil prices particularly welcome. Even so, the oil industry remains cautious given questions about the long-run demand.

Also providing an important tailwind for the economy is the government's commitment to additional immigration over the next few years.

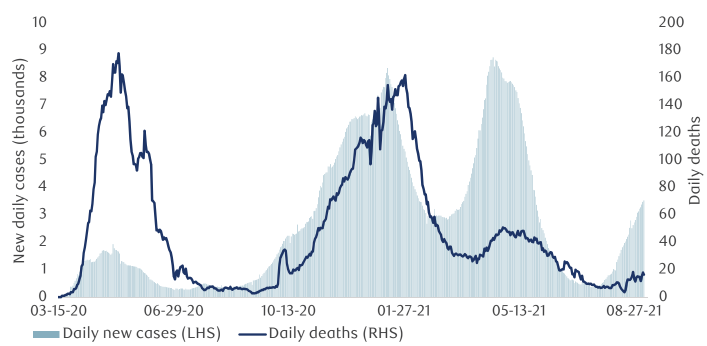
A Canadian election campaign is underway as this publication goes to print. The latest polls show a close race between the incumbent Liberals and the Conservatives, with a minority government significantly more likely than a majority. Both parties are proposing particularly expansive policies.

Exhibit 36: Significant progress made in Canada



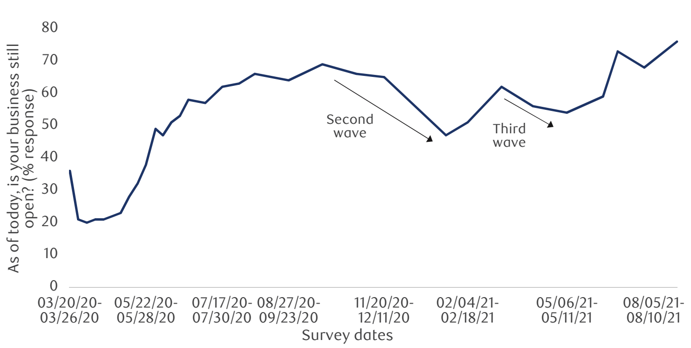
Note: Employment as of Jul 2021; retail sales, food services & drinking places, and industrial production as of Jun 2021. Trough since Feb 2020. Source: Macrobond, RBC GAM

Exhibit 37: Canada has entered a fourth wave; deaths are tame so far



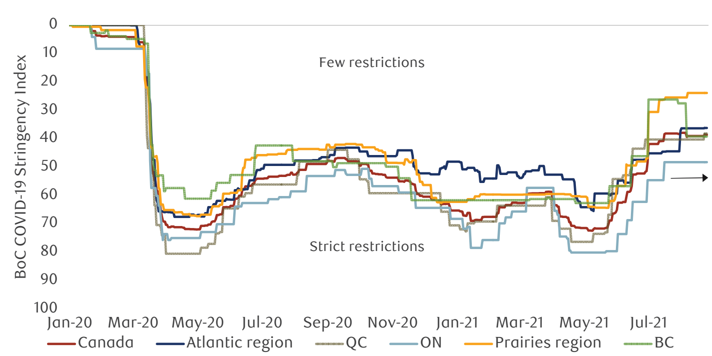
Note: As of 9/5/2021. 7-day moving average of daily new cases and new deaths. Source: WHO, Macrobond, RBC GAM

Exhibit 38: Canadian businesses continue to reopen despite rising cases



Note: As of 08/10/2021. Source: CFIB, RBC GAM

Exhibit 39: COVID-19 restrictions mostly stable in Canada



Note: As of 08/25/2021. Atlantic region includes New Brunswick, Newfoundland and Labrador, Nova Scotia and Prince Edward Island; Prairies region includes Alberta, Manitoba and Saskatchewan. Source: Bank of Canada, RBC GAM

Economic bottom line

Our forecasts call for below-consensus economic growth and above-consensus inflation, but these should not be the main takeaways. More important than the negativity that these forecasts might imply is our view that economic growth will be robust in the year ahead and that inflation, while slightly elevated, will at least partially normalize. In other words, the economic recovery should continue, with our business cycle scorecard hinting at several more years of economic expansion.

COVID-19 will remain with us for the foreseeable future, but the pandemic is transitioning into a phase in which it is less directly relevant to the economy because hospitalizations and fatalities are remaining tame even as infections rise, and because policymakers are swapping lockdowns for vaccine mandates and passports.

Our recommended asset allocation for a global, balanced investor remains for an overweight position in equities, though not to an extreme degree given the long rally that has already occurred. A portion of the fixed-income allocation has been shifted into cash in the hope of buying bonds at a better price given that yields are likely to rise over time, or equities at a better price were stocks to fall.

Turning to the long run, a number of themes must be kept in mind:

- The pandemic appears to be permanently changing some elements of the economy, including structural shifts toward more online shopping and virtual work. Interest rates will also likely be permanently lower than they would otherwise have been (though they can still rise modestly over time). Public debt loads are also higher.

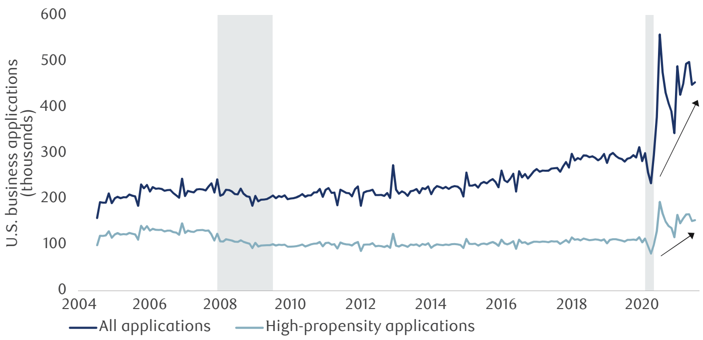
- We anticipate somewhat greater innovation in the future, in part because of changes brought on by the pandemic, and in part because of other supportive drivers. Providing a hint of this nascent trend, business formation has accelerated (Exhibit 40).

- The world has shifted to a multipolar era now that China challenges the U.S. in economic and geopolitical clout. This development suggests that geopolitical friction will persist.

- Demographic trends are unfriendly over the coming decades, limiting the rate of economic growth and likely dampening inflation.

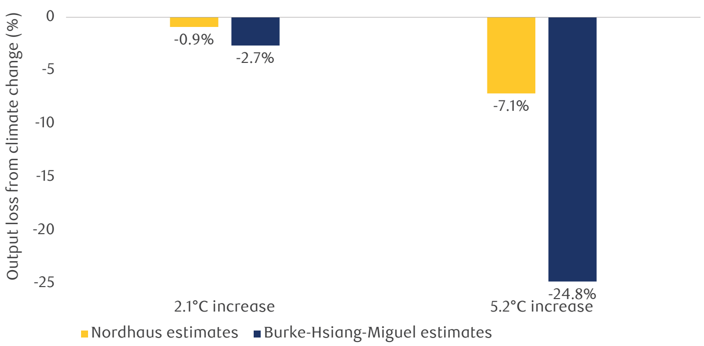
- Finally, climate change and the efforts to mitigate it are set to have a significant effect on the global economy over the 21st century, with wide-ranging estimates of the potential damage (Exhibit 41).

Exhibit 40: U.S. business applications boomed during the pandemic

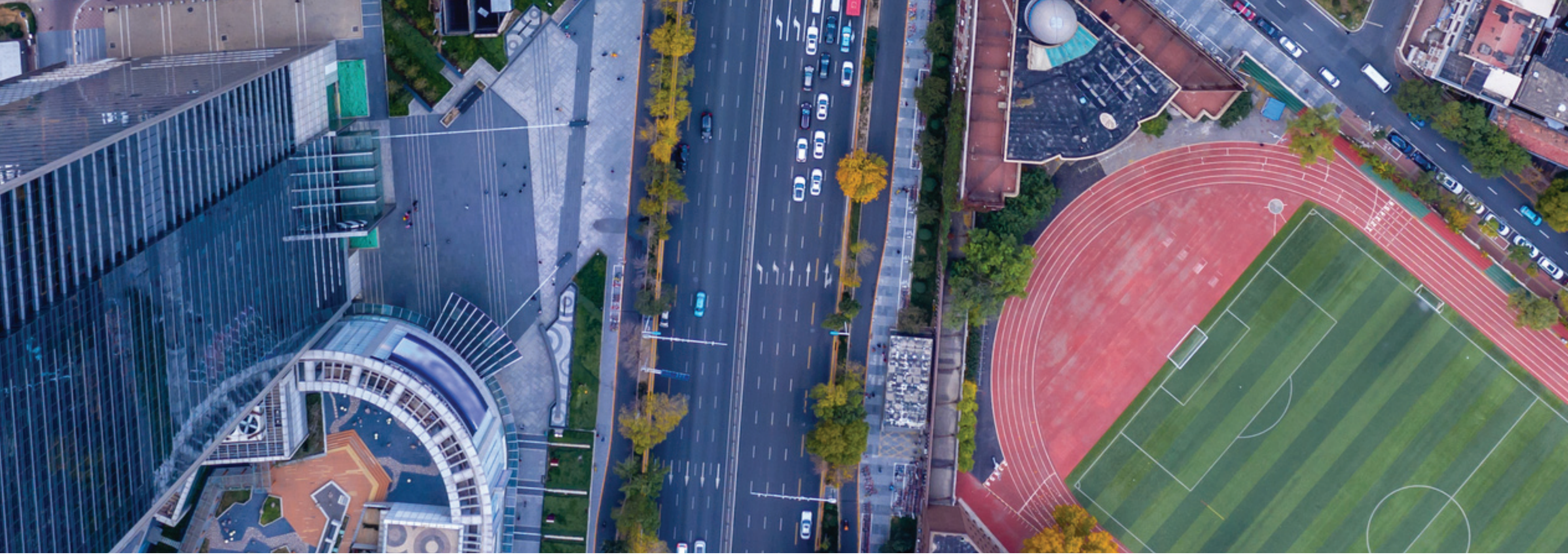


Note: As of Jul 2021. High-propensity business applications are more likely to turn into businesses with payroll. Source: Census Bureau, Macrobond, RBC GAM

Exhibit 41: Economic losses balloon as global temperature rises



Note: Estimated economic losses from climate change if global temperatures increase by 2.1°C and 5.2°C above preindustrial average. Source: Burke, Hsiang, and Miguel 2015; Nordhaus 2010; IMFWEO, October 2020; RBC GAM



Market outlook

Solid fundamentals keep bull market alive

Eric Savoie, MBA, CFA
Investment Strategist
RBC Global Asset Management Inc.

Daniel E. Chornous, CFA
Chief Investment Officer
RBC Global Asset Management Inc.

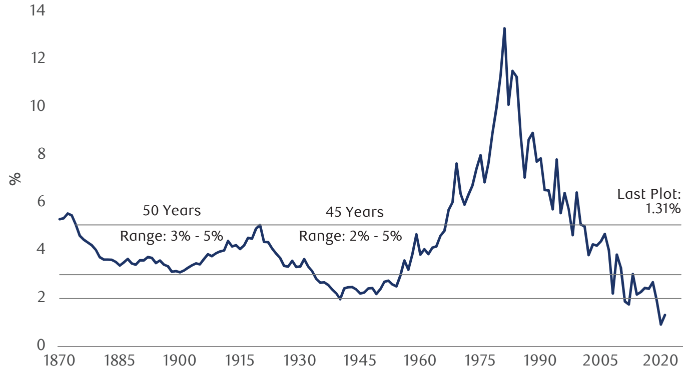
Stocks have continued their nearly uninterrupted ascent, rising above risks related to the coronavirus, geopolitical friction and concern that valuations are stretched on a variety of metrics (Exhibit 1). Fueling the equity-market rally has been a powerful surge in corporate profits, which are now above their pre-pandemic peak and which we expect to continue climbing at a rapid clip. Although the economy has moderated from what had been a historic pace of recovery, by some measures U.S. consumers have not been this flush in the modern era and are capable of supporting growth even as stimulus is ultimately withdrawn. Although equity markets and economies have more than recovered from the losses sustained at the start of the pandemic, we still find ourselves in a world where government-bond yields hover near their lowest levels in 150 years (Exhibit 2). We don't believe these ultra-low yields are sustainable and, in fact, a key factor guiding our asset-mix is our expectation that stocks will continue to outperform bonds, perhaps for many years to come.

Exhibit 1: MSCI World Index

U.S. dollars

Note: MSCI World Index in U.S. dollars. As of August 31, 2021. Source: Bloomberg, RBC GAM

Exhibit 2: U.S. 10-year bond yield



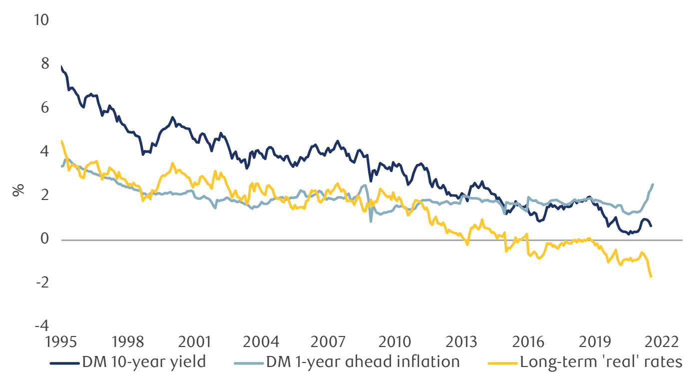
Note: as of August 31, 2021. Source: RBC GAM, RBC CM

In June 2020 we published *Evolving Our Strategic Asset Mix*, which outlined our motivation for last year's decision to raise the neutral equity allocation across our multi-asset strategies. We were inspired by a detailed analysis by the Bank of England explaining the drop in real interest rates through the past four decades.[1] Some of the main contributors to declining real rates were slowing population growth, the fact that emerging-market economies have generally matured, an increased preference for saving versus spending and elevated government-debt levels (exhibits 3 and 4). Many of these factors are unlikely to reverse anytime soon, so we may be stuck with a backdrop of ultra-low real rates for decades to come. Real interest rates act as the base rate for returns of all asset classes, and therefore it is reasonable to expect lower nominal returns for bonds and stocks as well (Exhibit 5). To generate the returns needed for many savings plans, investors will likely need to lean more toward higher-returning equities and away from sovereign bonds. While real rates have historically ranged between 2% and 3%, they may now settle at 0% to 1% going forward – an outlook that has far reaching implications for portfolio construction. With much lower coupons and expected returns, sovereign bonds especially are likely to provide less income, volatility dampening and downside protection within multi-asset portfolios. As a result, the role of bonds in a multi-asset portfolio will need to evolve.

In this environment, investors can adjust their strategies in several ways. One approach is to take a longer view. If investors don't need access to their savings in the immediate future, extending their time horizon can be helpful in withstanding equity-price fluctuations. Equities can be volatile, but with enough time they have always recovered and moved to new highs, as we are seeing again this cycle. We changed our own strategic positioning in June 2020, boosting the neutral exposure to equities in our recommended asset mix for global balanced investors to 60% from 55%, with the additional 5% taken from fixed income. For fixed-income markets, we think that absolute returns will become increasingly important, and that returns can be enhanced by progressively lowering sovereign-bond exposure in favour of corporate and other non-government

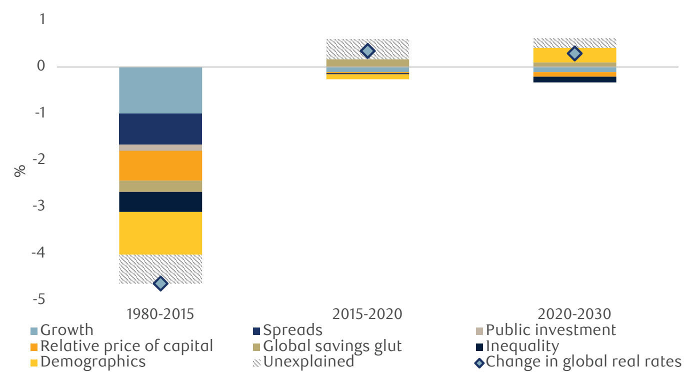
[1] Lukasz Rachel and Thomas D. Smith (December 2015). Bank of England Staff Working Paper No. 571: *Secular drivers of the global real interest rate.*

Exhibit 3: Real rates in developed markets



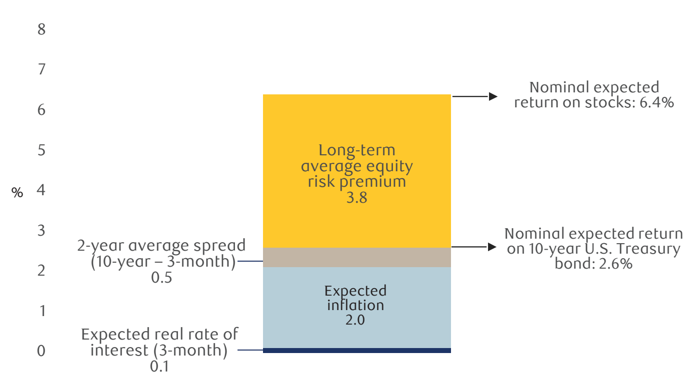
Note: As of July 31, 2021. Yields and inflation are GDP-weighted and consist of 20 developed market economies. Source: Bank of England, IMF, Consensus Economics, RBC GAM

Exhibit 4: Secular drivers of global real interest rates – Change in global neutral rate



Note: as of December 31, 2015. Source: Bank of England, RBC GAM

Exhibit 5: Long-term expected return on stocks



Note: as of April 30, 2021. Source: Bloomberg, RBC GAM bonds. Additional sources of diversification and attractive risk premiums can be sought in private markets and other alternative investments. While alternative investments may offer less liquidity, they can be stabilizing influences in portfolios when sovereign bonds are de-emphasized, frequently offering somewhat higher volatility and closer correlation to equities than bonds historically provided, but nevertheless higher cashflows and yields than stocks along with imperfect correlation. We think all of these options are worth considering in the context of a long-term view, which is the core of our investment strategy and front of mind when making asset-allocation decisions. This longer-term bias remains important even when efforts are made to profit from shorter-term market swings.

Turning our attention to the shorter term, our assessment of the current expansion is that it is likely in the early to middle stages, and that the next recession is still more than a year off. We do not think the U.S. Federal Reserve (Fed) will raise interest rates over the next year, though a reduction in bond buying is certainly possible in the coming months or quarters. Against a backdrop of good growth and moderate inflation, bond yields appear to be unsustainably low. As the COVID-19 crisis moves further into the background, we look for the yield on the U.S. 10-year Treasury bond to rise to 1.75% from 1.31% currently, resulting in modest losses over the next 12 months. For equities, valuations are high and will likely remain elevated as demographics reinforce the very long-term trends to lower nominal GDP growth and interest rates beyond the recovery from COVID-19. Moreover, stock prices are being validated by strong corporate profit growth, which we expect to continue over the next 12 to 18 months. Even with high valuations, we look for equity returns in the mid to high single digits and feel comfortable with a bias toward risk-taking. We recognize, however, that gains will likely be lower than we've enjoyed through the past year. We have left our exposure to stocks at 64% versus a neutral level of 60%, and lowered the fixed-income allocation twice in the past quarter, by 1% in July and 0.5% in August, and moved the proceeds to cash. For a balanced global investor, we currently recommend an asset mix of 64.0 percent equities (strategic neutral position: 60 percent) and 33.5 percent fixed income (strategic neutral position: 38 percent), with the balance in cash.

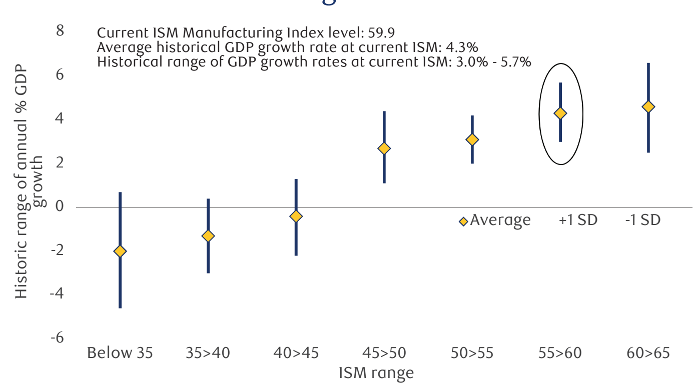
Economy moderates but expansion remains healthy

Investors may be concerned that economic growth has peaked and that a slowdown is on the horizon, as a rapid and powerful recovery has satisfied much of the pent-up demand from shutdowns. While many economic leading indicators do appear to have peaked, they remain at levels consistent with robust economic activity. The U.S. ISM Manufacturing Index, for example, has declined from its spring print but remains at a historically high level (Exhibit 6). This reading is important because it has been consistent in the past with real GDP growth of between 3.0% and 5.7% (Exhibit 7). Growth may have peaked, but sustaining the pace of recovery at rates indicated by the ISM would present a favourable backdrop for credit and equity investors especially.

Exhibit 6: U.S. ISM Manufacturing Index

Note: as of August 31, 2021. Source: Institute for Supply Management

Exhibit 7: United States ISM levels and real GDP growth estimates



Note: as of August 31, 2021. Source: Wolfe Trahan & Co.

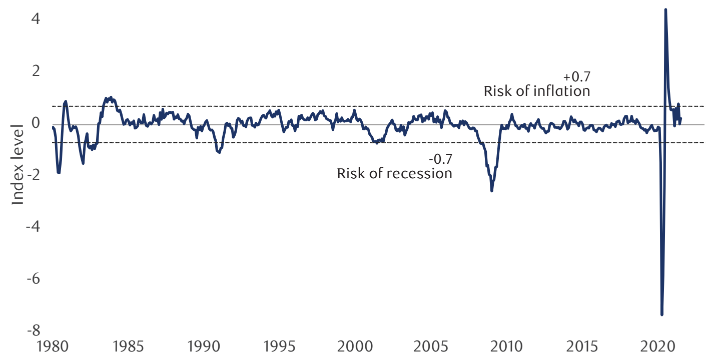
The economy may be settling back into a period of calm after the massive distortions caused by COVID-19. The Chicago Fed's National Activity Index (CFNAI), which tracks 85 economic indicators, was relatively stable in the decade between the financial crisis and the emergence of COVID-19 (Exhibit 8). The virus caused huge swings in this signal, which plunged as the economy fell into a deep recession, and then rebounded sharply toward readings indicating extreme inflation pressures as GDP staged a rapid but unbalanced recovery. After a year and a half of volatile economic conditions, the index is back to a flat reading at levels that were familiar prior to the pandemic, representing a balance of forces between inflation and recession.

> "Based on the DLI's recent climb to an all-time high, it is unlikely the economy will slip into recession before the fall of 2022."

The recovery was swifter and much more powerful than many investors expected, and economic-surprise indexes soared to their highest levels on record (Exhibit 9). But now that forecasters have rebased their expectations, the risk of disappointment has increased. Beginning in the summer, economic data has actually been coming in below the newly expected levels, representing a new source of risk for markets.

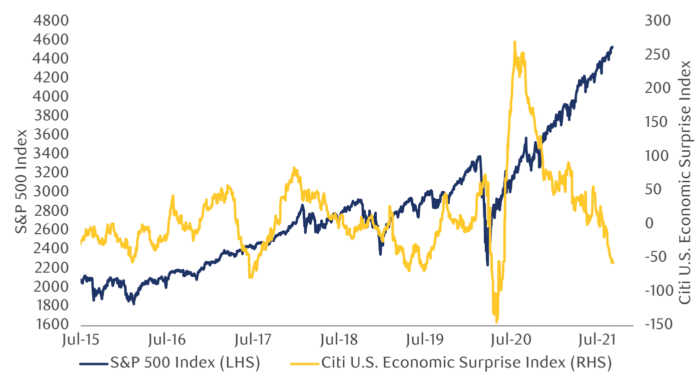
Although near-term risk of disappointment is evident in the economic surprise index, the outlook for the intermediate term remains compelling. The current expansion likely has room to run as one of the more reliable predictors of recession is not signaling cause for concern. The Duncan Leading Indicator (DLI), a ratio of consumer spending and fixed investment relative to sales, has in past cycles peaked an average of four quarters prior to the economy falling into recession (Exhibit 10). Based on the DLI's recent climb to an all-time high, it is unlikely the economy will slip into recession before the fall of 2022. Positioning the next recession beyond our forecast horizon means the expansion should remain a source of support for the bull market.

Exhibit 8: Chicago Fed National Activity Index
Three-month moving average



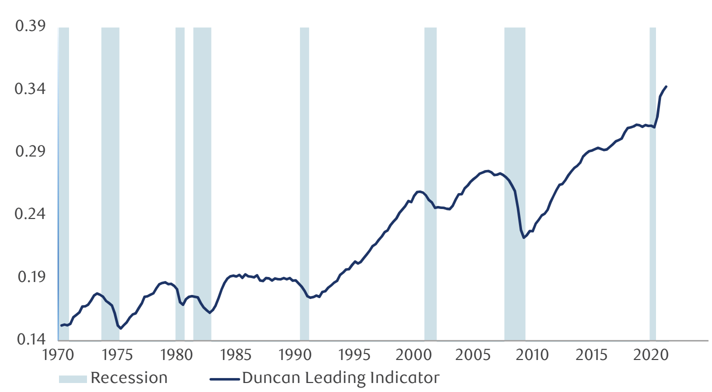
Note: as of August 31, 2021. Source: Federal Reserve Bank of Chicago, RBC GAM

Exhibit 9: S&P 500 and economic data surprises



Note: as of August 31, 2021. Source: Citigroup Alpha Surprise Index, Bloomberg, RBC GAM

Exhibit 10: Duncan Leading Indicator



Note: as of August 31, 2021. Source: Duncan Wallace, Morgan Stanley Research, Haver Analytics

Inflation fears abate

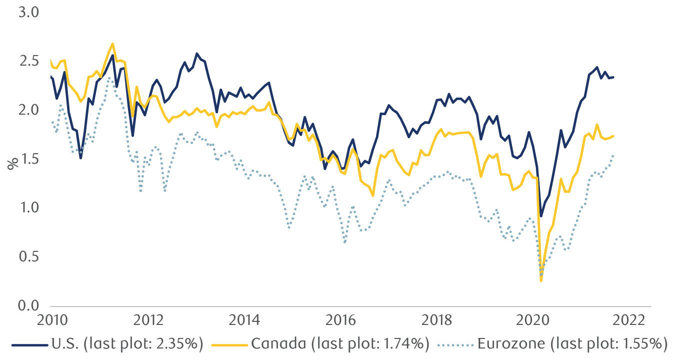
One of the main threats to the recovery has been the possibility of runaway inflation, but many investors and central bankers believe that the latest jump in consumer prices is transitory. A combination of surging demand and supply-chain disruptions has caused prices of goods and services to spike. This reflects the unusual shape of the economy's recovery from the COVID-19 recession and related restrictions. Pent-up demand is being released in an economy still suffering from supply-chain disruption. As both of these are gradually rebalanced, inflation should calm, and prior to a destabilizing change in long-term expectations. Investors seem to agree. Market-based measures of inflation expectations have stabilized around 2% or just below in North America and Europe (Exhibit 11) despite shocking recent prints for both consumer price inflation (CPI) and produce price inflation (PPI). The current consensus is for U.S. CPI to drift upwards in 2021, but come down in 2022, a further indication that inflation pressures are likely transitory and that we are moving past the worst (Exhibit 12).

Government indebtedness challenges future growth

After near-term risks linked to the virus eventually settle, the economy will likely face lasting consequences from the enormous monetary and fiscal relief that was unleashed during the pandemic. Most G-7 countries' debt-to-GDP ratios have swelled to record levels as their governments delivered massive stimulus to consumers and businesses in the form of support payments, forgivable loans and increased health-care spending (Exhibit 13). Significant erosion in balance sheets across nations has implications for the long-term growth outlook, interest rates and, ultimately, risk assets. Work by Reinhart and Rogoff immediately following the global financial crisis popularized the idea that a country's debt-to-GDP ratio above 90% typically results in a reduction in the real GDP growth rate of one percentage point (Exhibit 14). A backdrop against which highly indebted governments act as a headwind to growth will likely be a key feature of the economy for some time to come, reinforcing the dampening impact of demographic trends.

Exhibit 11: Implied long-term inflation premium

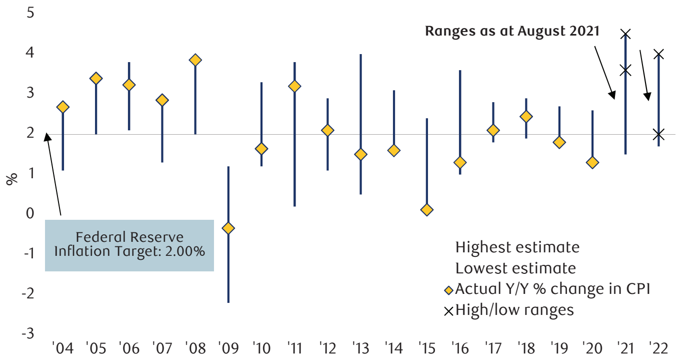
Break-even inflation rate: nominal versus 10-year real return bond



Note: as of August 31, 2021. Eurozone represents GDP-weighted breakeven inflation of Germany, France and Italy. Source: Bloomberg, RBC CM, RBC GAM

Exhibit 12: United States

Inflation estimate dispersion



Note: as of August 31, 2021. Source: Consensus Economics, RBC GAM

Exhibit 13: Global gross Debt/GDP ratios with IMF forecasts

	United States	Canada	France	Germany	Italy	Japan	United Kingdom
2009	86.8	79.3	83.0	73.0	116.6	198.7	63.2
2010	95.5	81.2	85.3	82.3	119.2	205.7	74.3
2011	99.8	81.8	87.8	79.7	119.7	219.1	80.0
2012	103.4	85.4	90.6	81.1	126.5	226.1	83.2
2013	104.8	86.1	93.4	78.7	132.5	229.6	84.2
2014	104.6	85.6	94.9	75.6	135.4	233.5	86.1
2015	104.7	91.2	95.6	72.3	135.3	228.4	86.7
2016	106.6	91.7	98.0	69.3	134.8	232.5	86.8
2017	105.6	88.8	98.3	65.1	134.1	231.4	86.3
2018	106.6	88.8	98.0	61.8	134.4	232.5	85.8
2019	108.2	86.8	98.1	59.6	134.6	234.9	85.2
2020	127.1	117.8	113.5	68.9	155.6	256.2	103.7
2021	132.8	116.3	115.2	70.3	157.1	256.5	107.1
2022	132.1	112.8	114.3	67.3	155.5	253.6	109.1
Prior peak	109.0	100.2	98.4	73.0	135.3	237.4	86.9
"Anticipated Deficit/GDP ratio for 2021"	-15.0	-7.8	-5.5	-7.2	-8.8	-9.4	-11.8

Note: anticipated peak. As of August 31, 2021. Source: IMF

Exhibit 14: Impact of sovereign debt on Real GDP growth
Selected advanced countries, average annual percent change

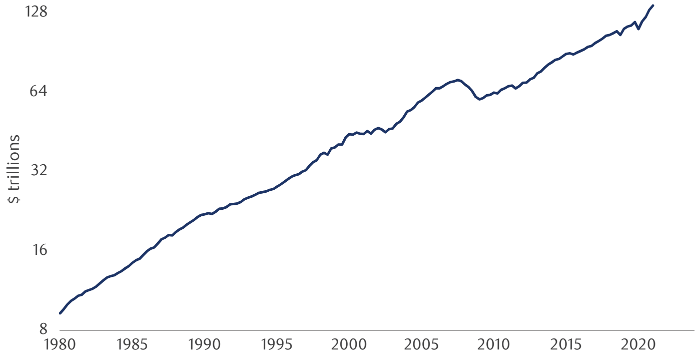
		Federal Government Debt/GDP			
Country	Period	Below 30 Percent	30 to 60 Percent	60 to 90 Percent	90 percent and Above
United States	1790-2009	4.0	3.4	3.3	-1.8
Canada	1925-2009	2.0	4.5	3.0	2.2
France	1880-2009	4.9	2.7	2.8	2.3
Germany	1880-2009	3.6	0.9	N/A	N/A
Italy	1880-2009	5.4	4.9	1.9	0.7
Japan	1885-2009	4.9	3.7	3.9	0.7
United Kingdom	1830-2009	2.5	3.4	2.1	1.8
20 Country Average		3.7	3.0	3.4	1.7
20 Country Median		3.9	3.1	2.8	1.9

Source: Reinhart, Carmen M., and Kenneth S. Rogoff. "Growth in a Time of Debt," IMF, OECD, World Bank, May 2010.

U.S. consumers in pristine position

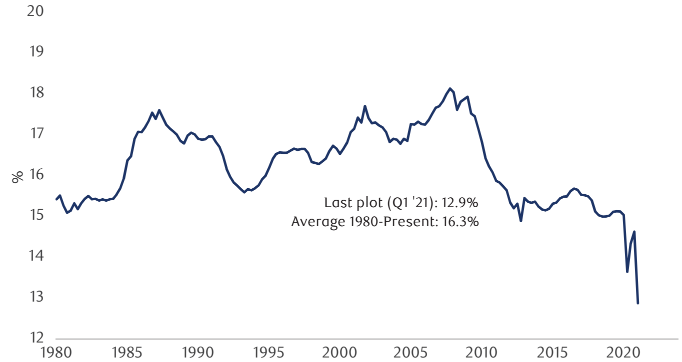
The good news is that consumers are in fabulous shape and have the power to keep driving the recovery forward. While government debt has ballooned, the financial position of U.S. consumers has, by some measures, never been better. Net worth is at an all-time high and the ratio of households' fixed spending obligations (i.e. house payment, car payment, utilities) as a proportion of disposable income is at its most favourable level in four decades (exhibits 15 and 16). Moreover, consumer confidence has rebounded close to its highest levels in the past 20 years across all income levels (Exhibit 17). While there are challenges to GDP given the evolution of global demographics and savings patterns, high sovereign-debt levels and moderating economic activity, we should also consider that households have plenty of firepower to extend the cycle.

Exhibit 15: U.S. consumer balance sheets – net worth – Households and non-profit organizations



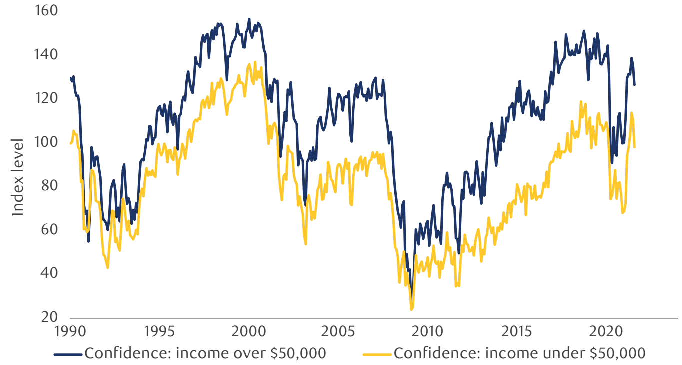
Note: as of August 31, 2021. Source: Federal Reserve

Exhibit 16: U.S. financial-obligations ratio
Total obligations as a % of personal disposable income



Note: as of August 31, 2021. Source: Federal Reserve

Exhibit 17: United States
Consumer confidence by income level



Note: as of August 31, 2021. Source: Federal Reserve

Monetary stimulus set to ebb

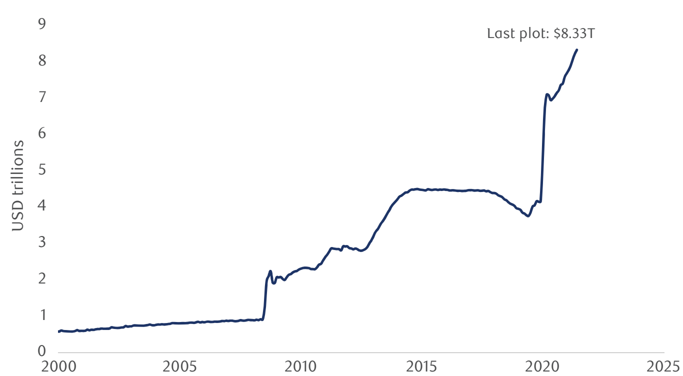
With the economy on a surer footing, a logical next step is for the Fed to begin scaling back the extent of its aggressive monetary-stimulus programs. Since March 2020, the Fed's balance sheet has expanded by approximately US$4.2 trillion, nearly doubling in size in less than two years, providing tremendous support and liquidity for the economy and capital markets (Exhibit 18). The current pace of US$120 billion in monthly bond buying may soon slow and the Fed has hinted that such tapering could occur as early as this year. Importantly, a reduction in quantitative easing should not be thought of as "tightening," but rather as a lessening in stimulus. An outright tightening of policy, in the form of interest-rate hikes, likely won't occur until tapering is complete, and pricing in the futures market suggests that might not take place until late 2022 or early 2023 (Exhibit 19).

Significant valuation risk in fixed income

Sovereign-bond yields declined meaningfully over the past quarter, reflecting slowing economic growth and a belief that central banks would tighten at a slower pace than initially thought. The U.S. 10-year yield fell as low as 1.17% this summer from a high of 1.75% in the spring and settled at 1.31% at the end of August. Sovereign-bond yields almost everywhere are once again well below our modelled estimates of equilibrium, suggesting fixed-income markets are expensive and vulnerable to a shift to higher yields (page 48).

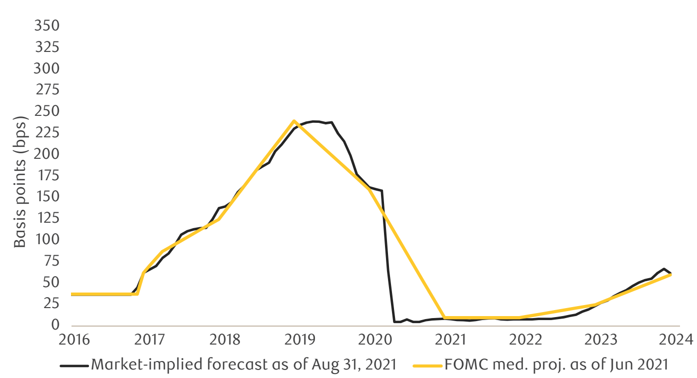
According to our models, the main reason yields are too low is that real interest rates are deeply negative and therefore likely to move higher. As outlined at the beginning of this article, research by the Bank of England suggests the long-term real rate of interest should be closer to zero or slightly above. We've incorporated part of the BOE's methodology into our own modeling and forecasting framework. Exhibit 20 plots the components of our model for the 10-year U.S. Treasury bond, which is made up of an inflation premium and a real (or after-inflation) rate of interest. While inflation recently spiked, overshooting our modelled level, we think it will eventually come back down as long as consumer price increases prove transitory. But real rates are extremely low at nearly 2% below zero, matching the lowest levels since the 1980s. At these rates, savers are subsidizing spenders, an unusual phenomenon that is unlikely to persist. We don't think real interest rates will move meaningfully above zero, but simply climbing back to zero as our model suggests would put upward pressure on yields. We expect this adjustment to take place gradually and look for the U.S. 10-year yield to climb to 1.75% over the next 12 months.

Exhibit 18: U.S. Federal Reserve
Balance-sheet assets



Note: as of August 31, 2021. Source: U.S. Federal Reserve, RBC GAM

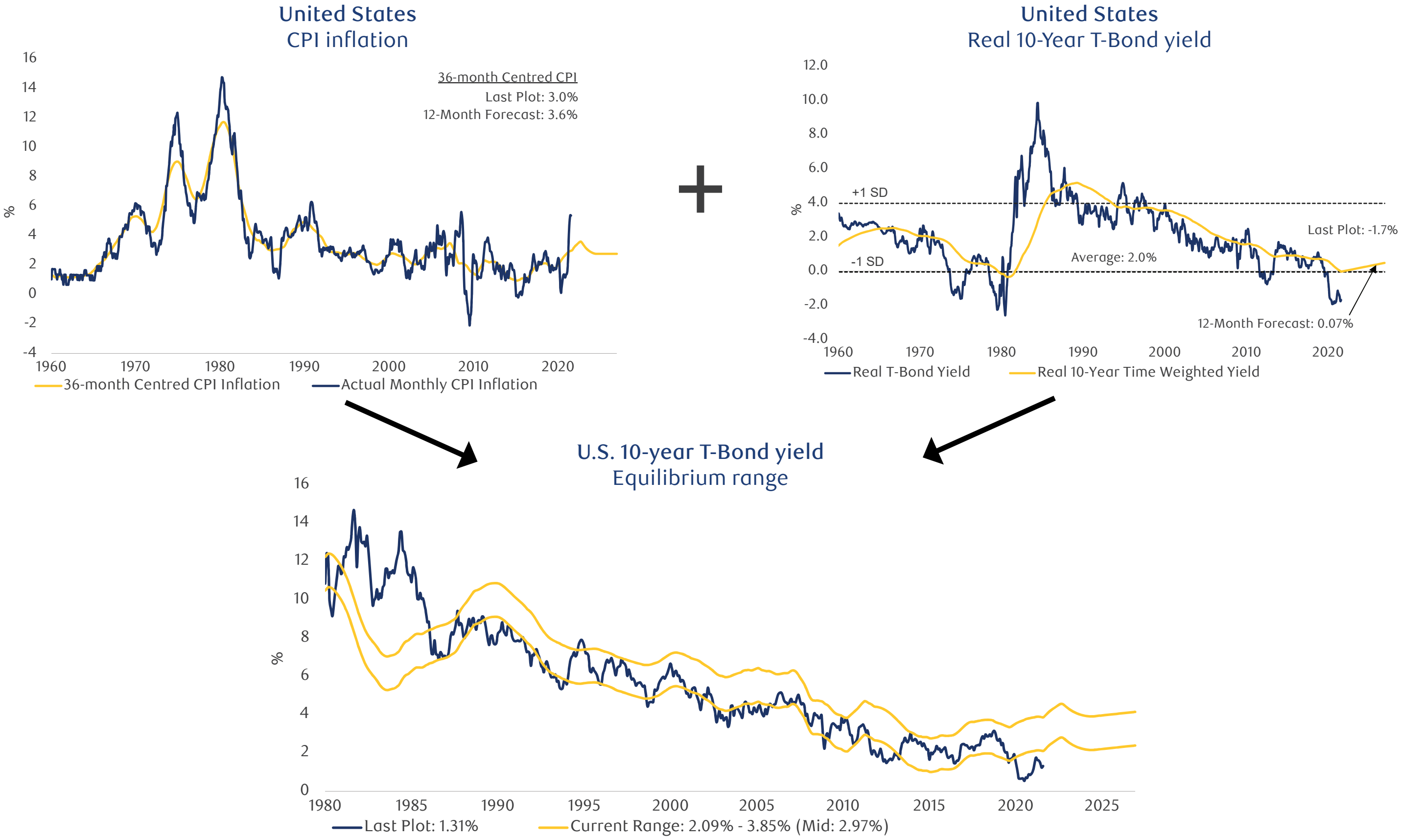
Exhibit 19: Implied fed funds rate
12-month futures contracts



Note: as of August 31, 2021. Source: Bloomberg, U.S. Federal Reserve, RBC GAM

Exhibit 20: U.S. 10-year bond yield

Fair-value estimate composition



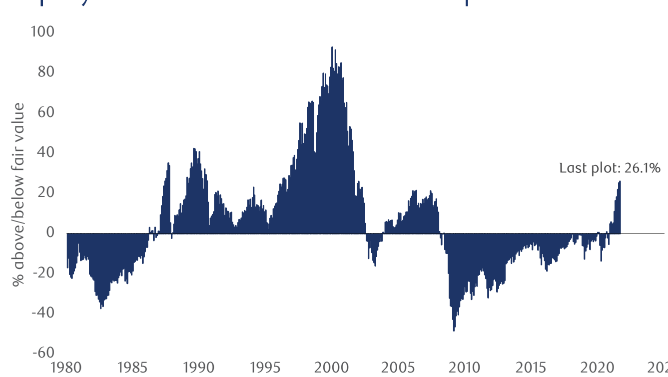
Note: as of August 31, 2021. Source: RBC GAM, RBC CM

Stocks extend gains, with valuations at their highest since the tech bubble

Equity markets have continued their upward trajectory during the summer amid still robust economic activity, low interest rates and tremendous corporate-profit growth. The S&P 500 has more than doubled from its March 2020 low and many global indexes have climbed to records over the past quarter. The rally over the past year has been powerful, pushing our composite of global stock-market valuations to 26% above fair value (Exhibit 21). This valuation composite has come a long way: it fell to 49% below fair value in the depths of the global financial crisis and didn't get back above fair value until November of 2020. The composite is now situated at its highest point since the late 1990s

Exhibit 21: Global stock-market composite

Equity-market indexes relative to equilibrium

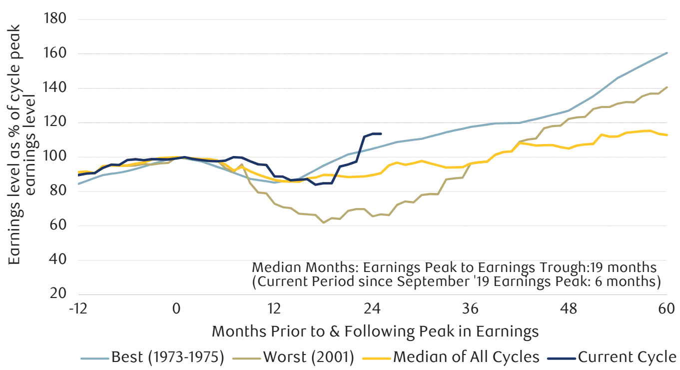


Note: as of August 31, 2021. Source: RBC GAM technology bubble. For a large part of the current bull market, the concern with overvaluation was mostly due to the extreme valuations observed in U.S. equities, while other stock markets had remained below and sometimes far below their fair value levels. But that's not necessarily the case anymore, as many markets are now reaching levels that are near fair value or expensive (page 49). While elevated valuations, on their own, are seldom the cause of bear markets, they do make stocks more vulnerable to shocks and can lead to periods of greater volatility.

Surging profits fuel stock-market rally

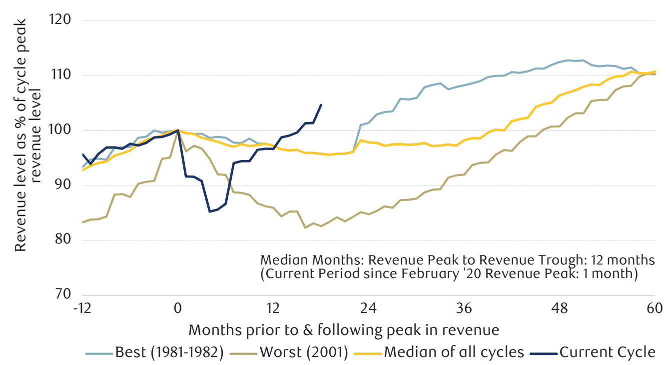
While there is little doubt that stocks are expensive, the backdrop for profits continues to be sound. Earnings and revenues recovered extremely fast this cycle, placing the current experience on track to be the most rapid recovery on record (exhibits 22 and 23). Looking ahead, our forecasts for economic growth continue to support further strong gains in revenues and profits. Exhibit 24 plots S&P 500 revenues alongside U.S. nominal GDP, showing our own forecasts which are consistent with double-digit gains in revenues for this year and next. Moreover, Exhibit 25 plots a simple regression of S&P 500 profits versus economic growth and suggests that our 2021 forecast of 10.5% nominal GDP growth in the U.S. would translate into profit gains of 33.6%, and for 2022 those numbers are 6.8% nominal GDP growth for an 18.0% increase in earnings – more than double the long-term norm of 7.0%.

Exhibit 22: S&P 500 Recurring Earnings
All earnings peaks associated with periods of recession



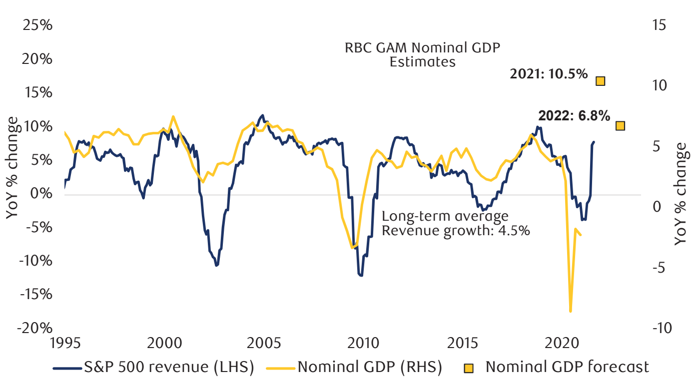
Note: as of August 31, 2021. Source: RBC GAM, RBC CM

Exhibit 23: S&P 500 revenue
All revenue peaks associated with periods of recession



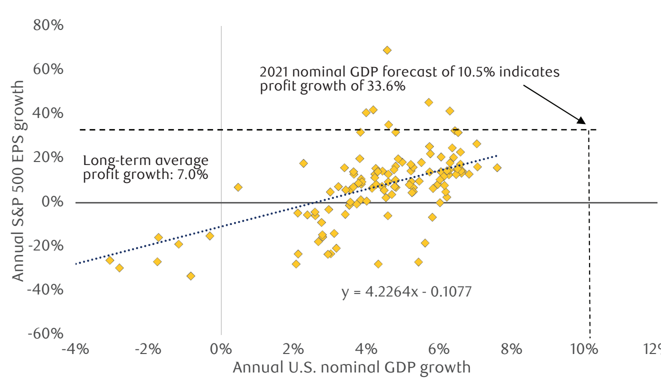
Note: as of August 31, 2021. Source: RBC GAM, RBC CM

Exhibit 24: United States
S&P 500 revenue and nominal GDP



Note: as of August 31, 2021. Source: RBC CM, RBC GAM

Exhibit 25: S&P 500 EPS vs U.S. nominal GDP growth



Note: as of August 31, 2021. Based on quarterly data back to January 1990. Source: Bloomberg, RBC GAM

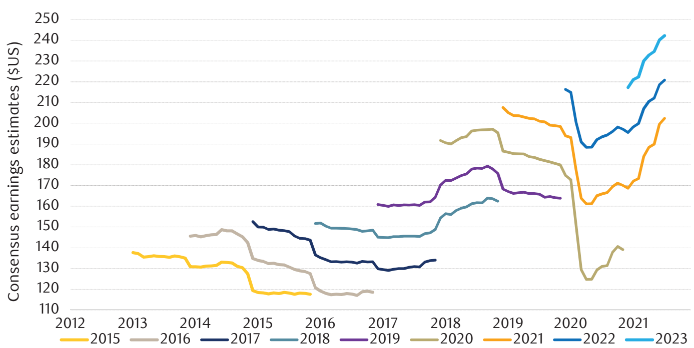
While economic data has moderated from its peak, corporate profits continue to soar and analysts can't seem to raise their estimates fast enough to keep pace with the strong recovery. Exhibit 26 plots the month-by-month progression of consensus estimates for S&P 500 earnings, which rose gradually between mid-2020 and late 2020, at which point they shot markedly higher as COVID-19 vaccines were announced and rolled out. Even with the strength of upward revisions to estimates, 88% of profit reports for S&P 500 companies in the past quarter still exceeded those expectations (Exhibit 27).

We should recognize that earnings have fully recovered from their earlier depressed levels and are now back at their long-term trend (Exhibit 28). As a result, further upside earnings surprises will depend on sustained growth above the long-term trend, which may be tougher to achieve, and headwinds such as tax hikes could pose further challenges.

Maintaining elevated valuations is critical to a bullish outcome for stocks

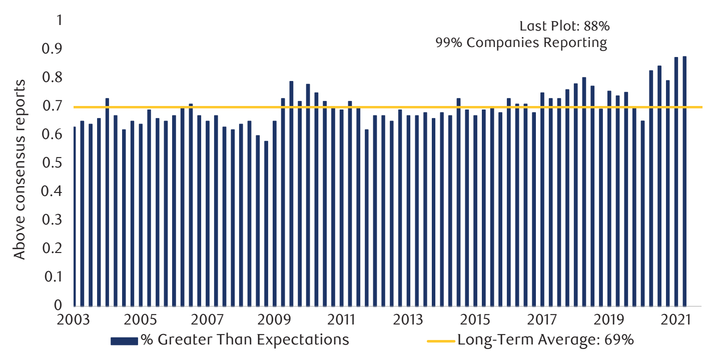
Our scenario analysis suggests that further upside is still possible for stocks over the next few years, but only if valuations remain elevated and/or earnings continue to exceed expectations. Exhibit 29 lists a variety of outcomes for the S&P 500 at the end of each of the next three years based on different price-to-earnings ratios (P/E) and assuming that earnings achieve the consensus of analysts' estimates. If the market trades at an equilibrium P/E of 17.6 – the long-term average valuation level during periods of

Exhibit 26: S&P 500 Index
Consensus earnings estimates



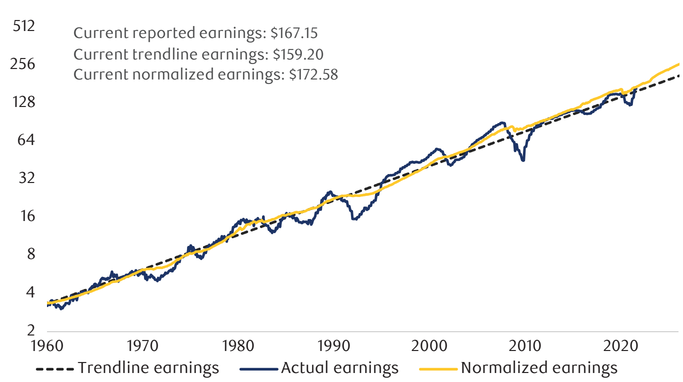
Note: as of August 31, 2021. Source: Thomson Reuters, Bloomberg

Exhibit 27: Companies reporting results above consensus forecasts



Note: as of September 8, 2021. Source: Refinitiv

Exhibit 28: S&P 500 earnings comparison



Note: as of August 31, 2021. Source: RBC GAM

Exhibit 29: Earnings estimates & alternative scenarios for valuations and outcomes for the S&P 500

		Consensus		
		2021 Bottom up	2022 Bottom up	2023 Bottom up
	P/E	$202.3	$220.8	$242.3
+1 Standard Deviation	21.8	4416.0	4819.2	5288.3
+0.5 Standard Deviation	19.7	3989.7	4354.0	4777.8
Equilibrium	17.6	3563.4	3888.8	4267.3
-0.5 Standard Deviation	15.5	3137.1	3423.6	3756.8
-1 Standard Deviation	13.4	2710.8	2958.3	3246.3

Note: as of August 31, 2021. Source : Bloomberg, Thomson Reuters, RBC GAM similar interest rates, inflation and corporate profitability – then the S&P 500 would be expected to deliver negative returns over the next two years. With the index trading at 4500 at the time of publication, the P/E would have to maintain a level of 0.5 standard deviation to one standard deviation above equilibrium to generate any further upside in 2022 and 2023. Should the S&P 500 deliver the expected US$242.30 in profits in 2023 and trade at a P/E of 21.8 (i.e. one standard deviation above equilibrium), the market could reach 5288 by the end of 2023, representing an annualized gain of 7% plus dividends. At half a standard deviation above equilibrium, those numbers would be 4778 on the index, or an annualized gain of 3% plus dividends. We think these mid-single-digit gains for the S&P 500 are possible since P/Es are likely to remain elevated in an environment of low interest rates, temporary inflation pressures and sustained growth in the economy. And if earnings estimates prove to be too conservative as they have been so far this cycle, positive surprises on earnings could provide further support for stocks.

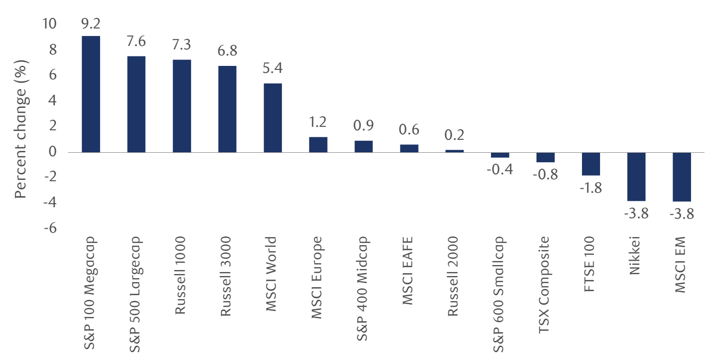
Shift in style leadership suggests tempered enthusiasm/moderating economic growth

Beneath the surface, movements within markets suggest the need for a bit more caution compared with earlier in the year. Small-cap and value stocks have ceded a large part of the gains that occurred in the months following vaccine announcements late last year (Exhibit 30). The outperformance of small-cap and value stocks is often a good indicator of confidence in an improving economic outlook because those stocks tend to benefit more from an acceleration in growth. Since the spring, leadership has shifted back to large-cap growth stocks, which is often consistent with a moderation or deterioration in economic conditions. In the past quarter, the S&P 100 mega-cap index was the best performer, and international stocks, particularly in emerging markets which tend to be more sensitive to changes in the economy, were laggards (Exhibit 31). While our outlook for the economy remains positive, we recognize and respect market cues that suggest the strongest growth impulses in the economy may now be behind us.

Exhibit 30: Relative style performance

Note: as of August 31, 2021. Source: Bloomberg, RBC GAM

Exhibit 31: Major indexes' price change in USD
June 1, 2021 to August 31, 2021



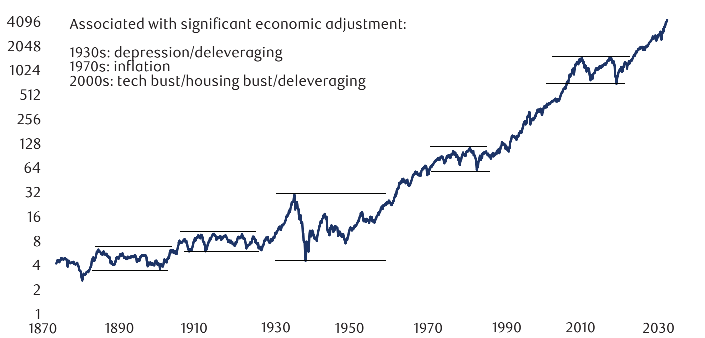
Note: as of August 31, 2021. Source: Bloomberg, RBC GAM

Supercycle favours risk taking

The long list of things to worry about in the near term, from valuations to moderating economic growth rates, does not deter us from finding comfort in the long-term trend for equities, which we believe continues to point upwards. Exhibit 32 plots a 150-year history of U.S. stocks, which have moved significantly higher over time, interrupted by long periods where markets have stalled. These periods are typically measured in decades rather than months, quarters or even years and are associated with significant economic disruption. But after long periods of sideways movement, stocks have embarked on steep upward trajectories that are sustained for decades at a time. We call these periods supercycle bull phases. Our long-term price momentum indicator turned higher in 2016, confirming our view that the S&P 500 had moved into a supercycle bull phase (Exhibit 33). The last time that occurred was in the early 1980s which was followed by almost 20 years of solid gains.

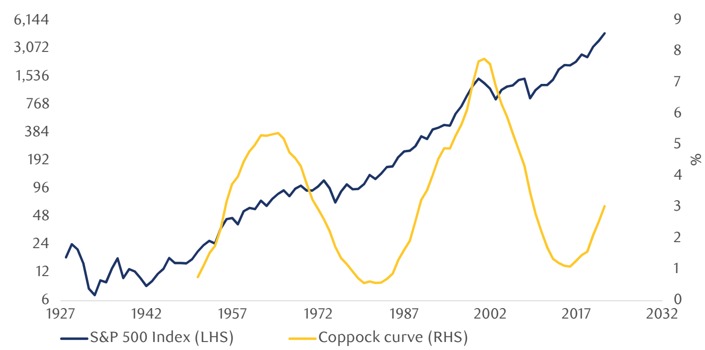
Whether we are in a supercycle bull or bear market has important implications for investors. There are noticeable differences in the duration and magnitude of rallies and corrections within the longer-term trend. Against the backdrop of a supercycle bull market, the gains during rallies have been double what they were during supercycle bear markets, and the scope of corrections half what they were during the bear phases (Exhibit 34). Interestingly, the COVID-19 bear market from early 2020 conformed closely to what should be expected during a supercycle bull market. The decline was short lived and risk assets ultimately ended up being the place to be for investors as stocks bounced back to record highs. While we will only be able to truly

Exhibit 32: Range-bound markets & cyclical bull phases – S&P 500 - 1870-2021



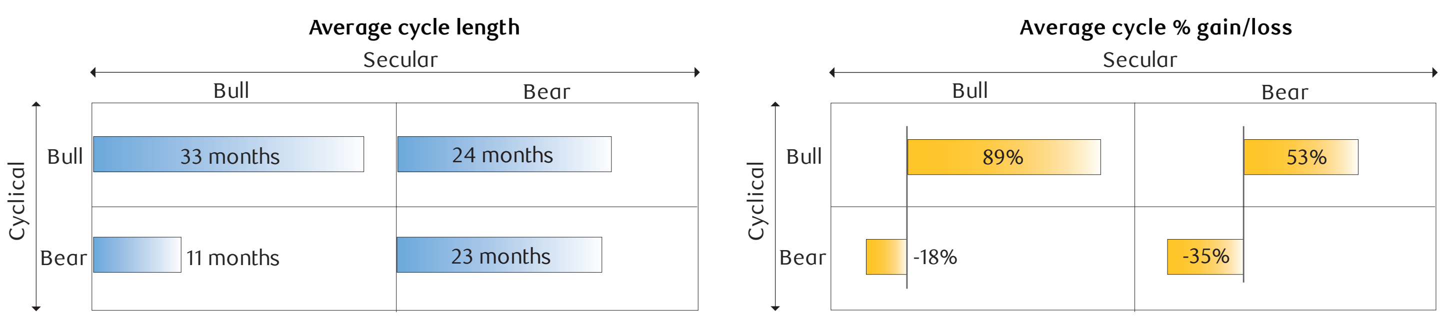
Note: as of August 31, 2021. Source: RBC GAM, Robert J. Shiller

Exhibit 33: S&P 500 Index
Supercycle price momentum



Note: Coppock curve based on yearly data as of August 31, 2021. Source: Bloomberg, RBC CM, RBC GAM

Exhibit 34: U.S. equity-market cycle statistics



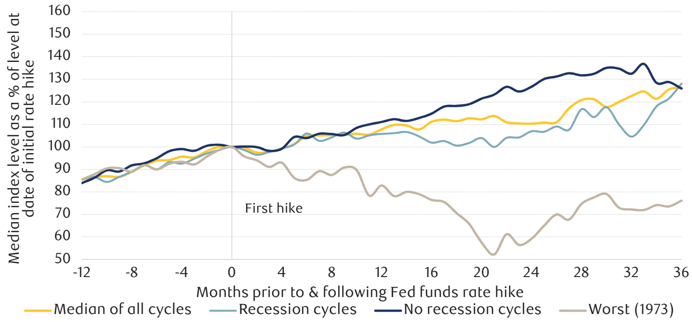
Source: RBC GAM

assess the true state of the supercycle many years from now, we think it is important to take an educated guess. Our belief that we are indeed in a supercycle bull market supports our ongoing bias in favour of risk assets.

Stocks have fared well ahead of monetary tightening cycles

Another aspect that supports higher stock prices is the fact that equities have almost always risen leading into periods of monetary tightening. Exhibit 35 plots a roadmap of the S&P 500 through past periods of Fed tightening with t=0 on the chart marking the date of the first U.S. rate hike through 17 cycles back to 1954. The lines on the chart group cycles dependent on the ultimate impact of interest-rate hikes on the economy (i.e. soft landing versus recession). Notice that the lines only deviate after rate hikes were underway (after t=0 on the chart). In the 12 months prior to the first hike, all the lines are rising at almost the same pace. We are moving into this window with a first hike anticipated sometime in late 2022/early 2023. Exhibit 36 plots detailed return statistics for each of the individual cycles along with the aggregate results of the entire set. Of the 17 cycles identified since 1954, only two experienced a decline in the 12 months leading up to the first hike, and based on a median reading, stocks were up 17% over the one-year

Exhibit 35: S&P 500 and the Fed funds rate hike
Implications for current cycle, following first rate hike



Note: as of August 31, 2021. Source: RBC GAM

periods in a range of -12.2% to 34.3%. In nearly half of the tightening cycles, recession was avoided and stocks continued their upward trajectory at a median pace of 8% in the 12 months following the first hike. As long as the Fed is not "behind the curve" when it begins the next cycle of rate hikes and is clear with messaging, tightening is not necessarily a problem because investors understand that appropriate monetary policy stabilizes the economy.

Exhibit 36: S&P 500 return statistics prior to and following the first rate hike
Data since July 1954

		Trailing returns (%)		Forward returns (%)*			
		12 months	6 months	6 months	12 months	24 months	36 months
April 1955		34.3	19.8	11.6	27.4	9.8	4.6
September 1958		18.0	18.6	10.8	13.6	3.4	10.1
July 1963		21.4	5.8	11.1	21.9	11.5	8.1
November 1967		17.1	4.1	3.5	13.2	-0.4	-3.3
December 1968		13.0	7.0	-9.1	-14.6	-8.2	-2.1
July 1971		29.8	6.5	4.3	7.8	3.3	-5.8
January 1973		17.0	11.1	-14.7	-17.2	-23.0	-8.7
August 1977		-5.8	-2.8	-9.5	5.8	5.0	8.6
September 1980		15.5	19.2	5.9	-4.7	-0.6	9.4
March 1984		3.0	-6.6	6.1	14.1	23.3	23.5
April 1987		22.4	18.3	-12.7	-9.4	3.6	4.7
March 1988		-12.2	-19.2	4.8	12.4	14.5	13.0
February 1994		4.5	4.7	-2.4	1.9	16.3	18.9
March 1997		21.4	15.1	18.9	39.6	27.9	24.6
June 1999		21.1	11.4	6.7	6.0	-5.6	-10.3
June 2004		17.1	2.8	6.4	4.4	5.5	9.6
December 2015		5.1	-1.1	0.2	8.9	13.6	7.8
	# of observations	Median trailing returns (%)		Median forward returns (%)*			
All cycles	17	17.1	6.5	4.8	7.8	5.0	8.1
No-recession cycles	8	19.2	5.3	3.9	11.1	12.6	8.0
Recession cycles	9	17.0	11.1	5.9	5.8	3.4	8.6

First rate hike

Source: RBC GAM. *periods greater than 12 months are annualized

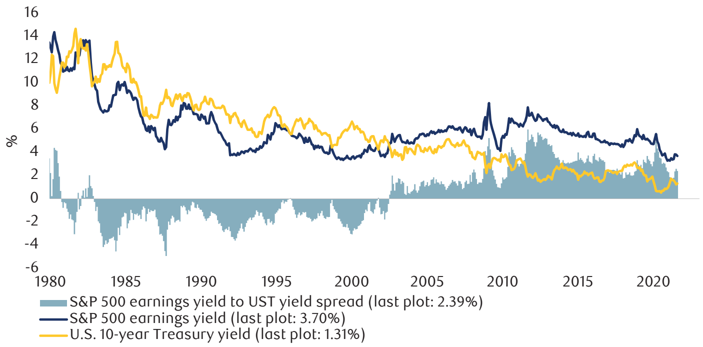
Asset mix – trimming fixed-income allocation in favour of cash

In our base case scenario, the economy grows at a rapid, yet moderating, pace and supports above-average corporate profit growth. Against this backdrop, the need for extraordinary policy support is less obvious and we expect massive stimulus programs, including quantitative easing by the Fed, to be dialed back at a gradual pace and telegraphed well in advance. Some risks to our base case include slowing growth in China, geopolitical risks related to Afghanistan and the continuing battle with the coronavirus.

As we continue along the path to normalization, prospective returns for fixed income are especially unappealing. From current levels, even a slight increase in yields would result in negative returns for sovereign bonds. Our 1-year return forecasts for sovereign bonds range from flat to slightly negative across the major markets that we track. We have therefore taken advantage of the recent decline in yields to again reduce our fixed-income allocation, where we had already been underweight. We trimmed our fixed-income position by one percentage point in July and by another 0.5 percentage point in August, moving the proceeds to cash.

Stocks continue to offer superior upside potential relative to fixed income, and our base case scenario forecasts returns in the mid-to-high single digits for equities over the year ahead. Although valuations are elevated, we have been reluctant to cut exposure to equities as we believe the economic cycle is still in its early to middle stages and corporate profits have room to run. Moreover, a substantial premium in expected returns for stocks versus bonds still exists, supporting our decision to maintaining an overweight allocation in stocks and underweight in bonds (Exhibit 37). Should yields rise and/or stocks decline, our increased cash position offers a cushion against volatility and provides the flexibility to re-deploy funds as opportunities arise. For a balanced global investor, we currently recommend an asset mix of 64.0 percent equities (strategic neutral position: 60 percent) and 33.5 percent fixed income (strategic neutral position: 38 percent), with the balance in cash.

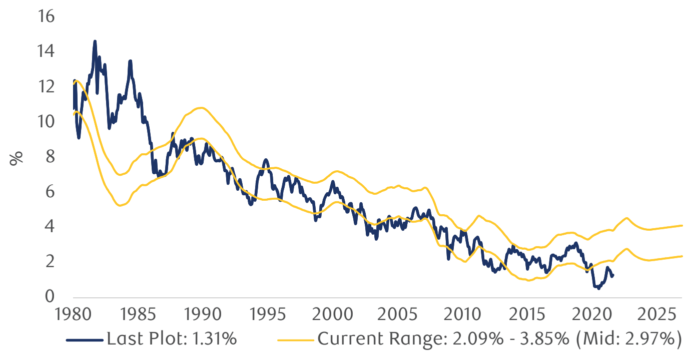
Exhibit 37: S&P 500 earnings yield
12-month trailing earnings/index level



Note: as of August 31, 2021. Source: RBC GAM, RBC CM

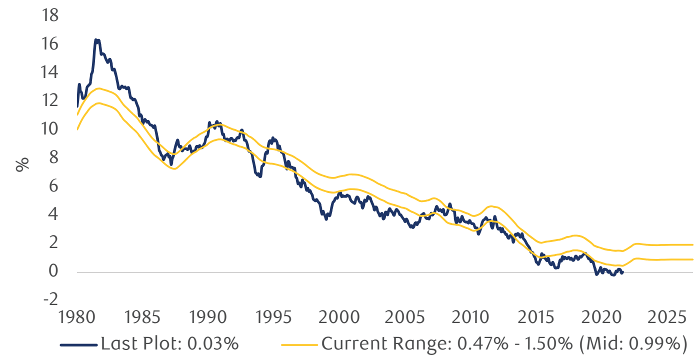
Global Fixed Income Markets

U.S. 10-Year T-Bond Yield
Equilibrium range



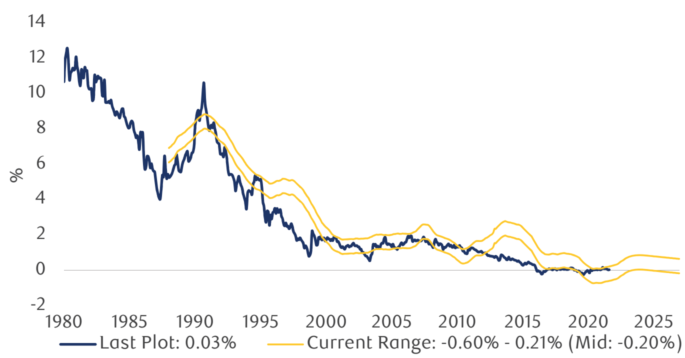
Note: As of September 1, 2021. Source: RBC GAM, RBC CM

Eurozone 10-Year Bond Yield
Equilibrium range



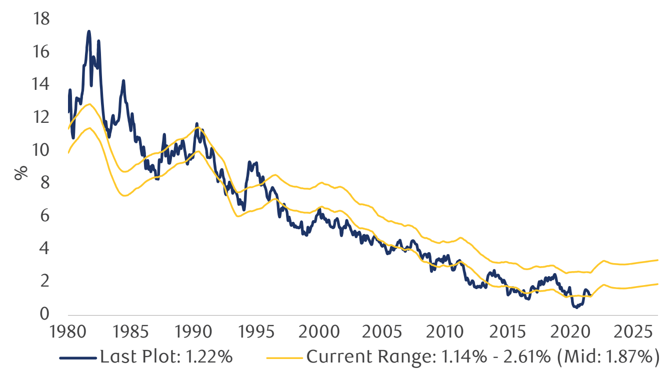
Note: As of September 1, 2021. Source: RBC GAM, RBC CM

Japan 10-Year Bond Yield
Equilibrium range



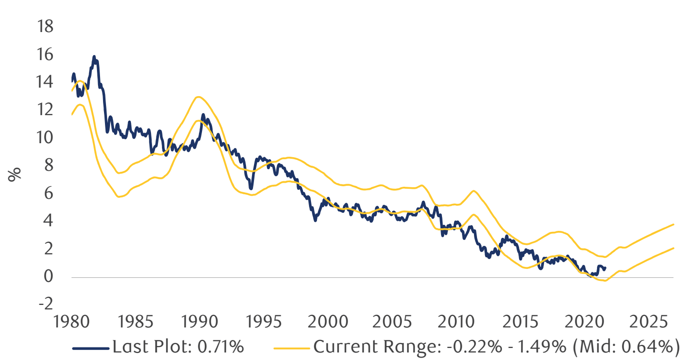
Note: As of September 1, 2021. Source: RBC GAM, RBC CM

Canada 10-Year Bond Yield
Equilibrium range



Note: As of September 1, 2021. Source: RBC GAM, RBC CM

U.K. 10-Year Gilt
Equilibrium range

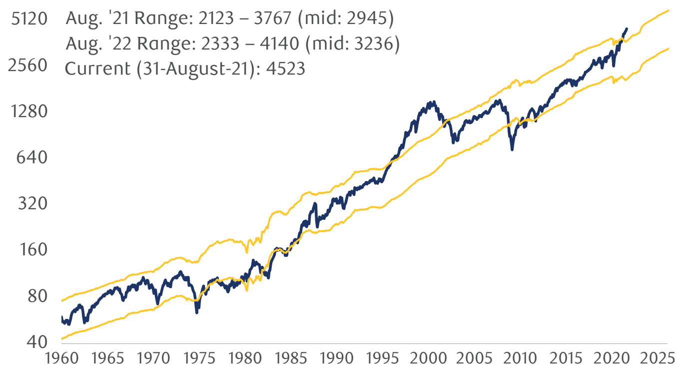


Note: As of September 1, 2021. Source: RBC GAM, RBC CM

"Sovereign-bond yields almost everywhere are once again well below our modelled estimates of equilibrium, suggesting fixed income markets are expensive and vulnerable to higher yields."

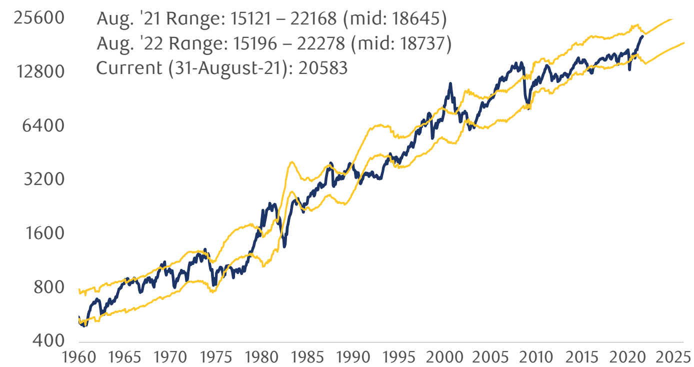
Global Equity Markets

S&P 500 Equilibrium
Normalized earnings and valuations



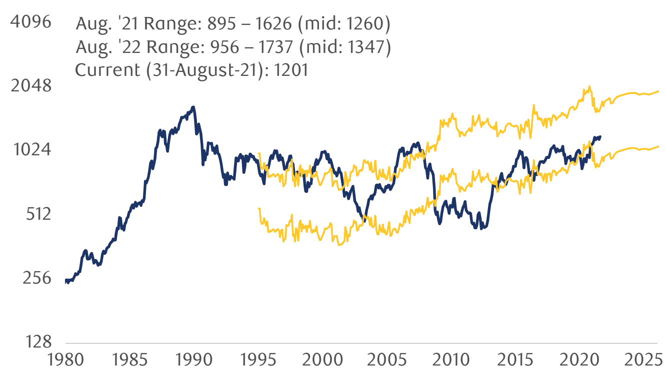
Source: RBC GAM

S&P/TSX Composite Equilibrium
Normalized earnings and valuations



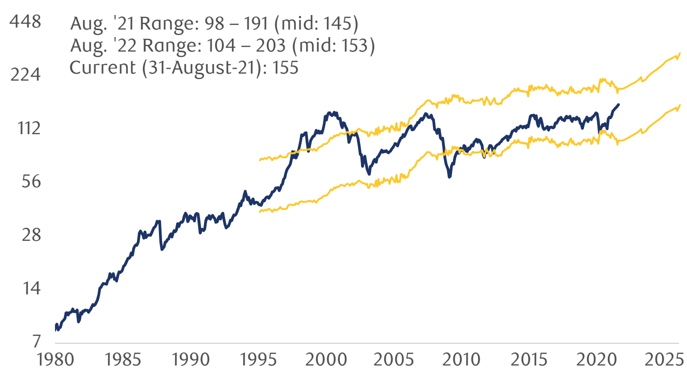
Source: RBC GAM

MSCI Japan Index
Normalized earnings and valuations



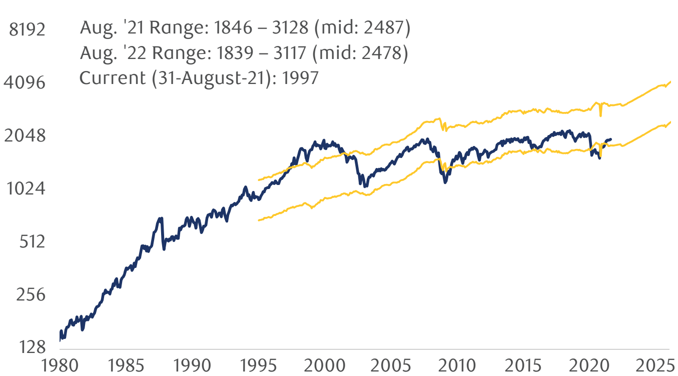
Source: RBC GAM

MSCI Europe Index
Normalized earnings and valuations



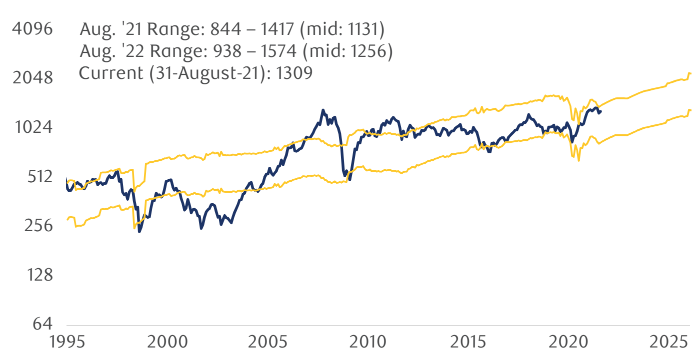
Source: RBC GAM

MSCI U.K. Index
Normalized earnings and valuations

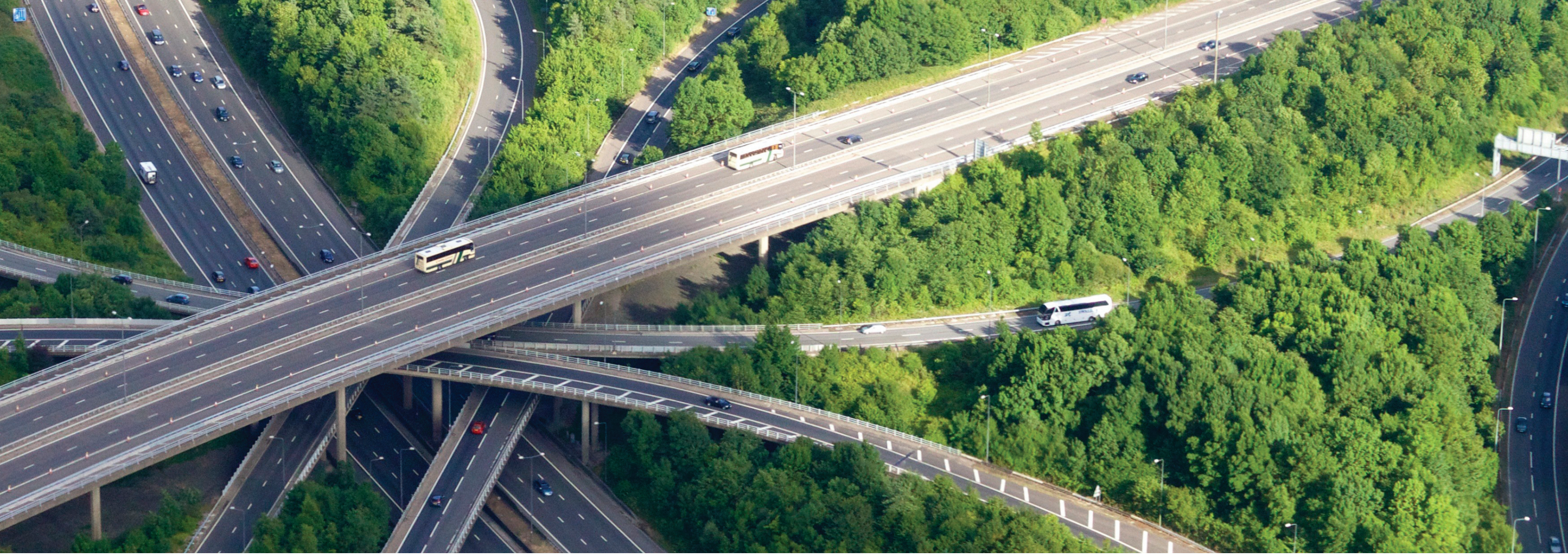


Source: RBC GAM

MSCI Emerging Markets Index
Normalized earnings and valuations



Source: RBC GAM



Global Fixed Income Markets

Soo Boo Cheah, MBA, CFA
Senior Portfolio Manager
RBC Global Asset Management (UK) Limited

Suzanne Gaynor
V.P. & Senior Portfolio Manager
RBC Global Asset Management Inc.

Taylor Self, MBA
Associate Portfolio Manager,
RBC Global Asset Management Inc.

Bond yields have declined over the past several months on investors' concerns that the coronavirus variant known as delta will undermine the economic recovery. While we cannot rule out the emergence of an even more virulent variant, we believe that bond yields have fallen too far. Much of the globe should experience above-trend economic growth for an extended period, supported by a continued reopening of the economy and supportive monetary and fiscal policies. In our view, government-bond yields are likely to climb over the next 12 months. We forecast that the 10-year U.S. Treasury yield will rise to 1.75% sometime over the next year from about 1.31% currently.

Recent events in New Zealand show us why yields will be sensitive to COVID-related developments over shorter periods. New Zealand had enjoyed relatively robust economic growth and above-target inflation for most of this year, and the country's central bank was expected to be among the first in developed markets to raise interest rates. However, a COVID-19 outbreak and mid-August lockdown on the eve of a monetary-policy meeting derailed the widely expected interest-rate hike.

We don't believe that New Zealand holds many lessons for other markets. The government has relied on travel bans and strict quarantines rather than inoculations, making lockdowns a necessity to combat the spread of the virus. By contrast, countries with extensive vaccination campaigns have seen deaths plummet as significantly fewer people are ending up in hospital with serious cases. In these countries, governments can more readily lift restrictions on economic activity because the likelihood that a surge in COVID cases will overwhelm medical facilities is greatly diminished. It is the central banks of these countries that will probably be the first to raise interest rates, likely accompanied by higher bond yields.

The more relevant case for most bond markets, to our mind, is the U.K. reopening, which was all but completed by July 19. Unlike New Zealand, which has one of the lowest vaccination rates in the developed world, the U.K. has one of the highest. The effectiveness of the vaccine, combined with widespread adoption in the U.K., meant that the economy continued to return to normal without overwhelming the hospital system – even with a surge in delta cases over the summer (Exhibit 1). This experience bodes well for other countries that lifted restrictions later and also have high vaccination rates. The evidence suggests that vaccines are breaking the economically damaging cycle whereby cases fall, business opens up, cases surge, lockdowns resume, cases fall… and so on.

The successful vaccine rollouts mean that the economic recovery has progressed far more quickly than most central bankers and economic forecasters anticipated, even as recently as the first few months of this year. Inflation, running at the fastest pace in a decade in North America, has also exceeded expectations. We believe that the inflation surge is temporary. Most of the rise so far is related to pent-up demand coming into conflict with supply-chain issues such as last month's two-week closure of a Chinese port that is the world's third-busiest, due to a COVID outbreak. Nevertheless, bondholders and central bankers should not fully discount the possibility that higher inflation is here to stay.

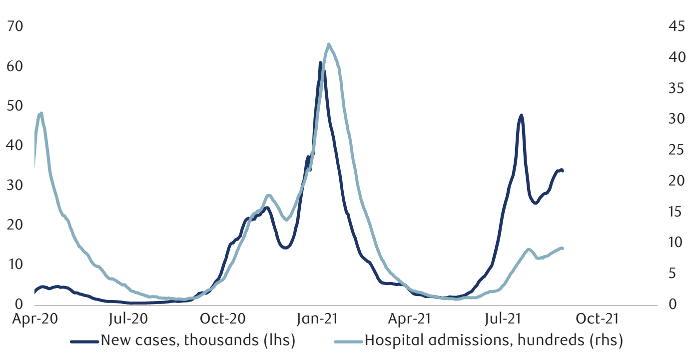
Labour markets in many countries are also on the mend with robust job creation and wage growth. We expect the strong labour market to persist into next year amid strong demand from reopening businesses and the expiry of pandemic-related unemployment benefits.

The sense that the worst of the pandemic's economic effects are in the past has infected the minds of central bankers. Most are actively plotting a retreat from emergency levels of support for their economies. The U.S. Federal Reserve (Fed) is widely expected to begin reducing the pace of asset purchases by early 2022, with an announcement expected before the end of this year. We don't expect any decrease in bond purchases by the Fed to lead to a pronounced rise in yields as happened during the "taper tantrum" in 2013 because the taper is well telegraphed this time, and the expected reductions are likely to be more than offset by a decline in bond issuance next year as Congress spends less on pandemic-related relief and as tax revenues rise.

Also differing from 2013 is the economic situation. Today's labour market and economy are strong and inflation is much higher (Exhibit 2). As a result, there is broad agreement that the Fed should start down this path, whereas in 2013 then-Fed Chair Ben Bernanke surprised investors with his intention to scale back bond purchases. Ultimately, the scale of Fed bond purchases on a month-to-month basis is less important than what a shift toward reducing bond purchases says about future interest-rate hikes. Policymakers want to halt asset-purchase programs in advance of hiking interest rates, and the beginning of the tapering process is a key signal that the Fed will eventually follow with rate hikes.

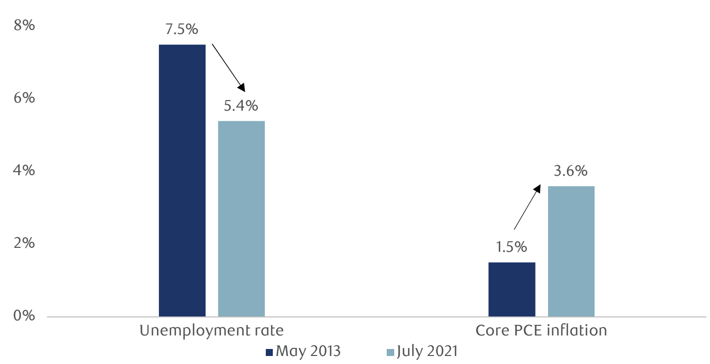
We recognize that it could be some time before central bankers proceed with rate increases. Our view is that the Fed's first rate move will likely come sometime in 2023 after the central bank scales back bond purchases to its satisfaction. That said, investors do not think interest rates will be rising as much as the Fed's forecasts suggest: investors expect just two rate hikes in 2023 – a number that one would expect to be higher if the labour market and inflation were satisfying the Fed's prerequisites. Investors are also less optimistic about how high U.S. interest rates can rise. U.S. interest-rate markets imply that the fed funds rate will rise to 1.70% in five years' time, compared with the 2.50% rate indicated by Fed policymakers as their long-run policy rate (Exhibit 3).

Exhibit 1: U.K. Coronavirus waves
New cases and hospital admissions



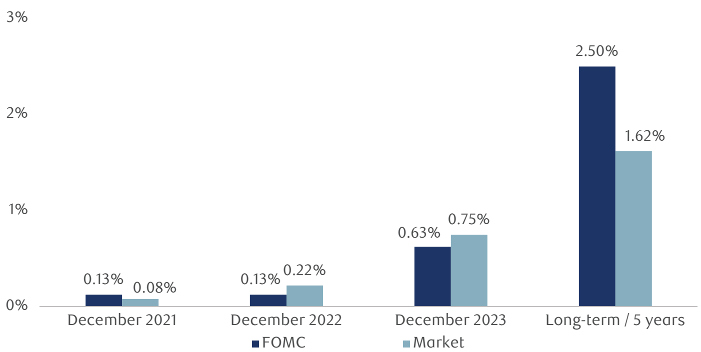
Note: As of August 28, 2021. Source: U.K. Government

Exhibit 2: U.S. economic data ahead of tapering
Unemployment rate and core PCE inflation, percent



Note: As of July 2021. Source: U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Analysis

Exhibit 3: Expectations for the fed funds rate
FOMC forecasts and market-implied interest rates



Note: SEP as of June 2021, market expectations as of September 1 2021.
Source: FOMC Summary of Economic Projections (SEP), Bloomberg

As mentioned above, we are slightly more sanguine than the market, and more aligned with Fed forecasts. Over the next year or so, most economies should continue to record above-trend growth, supporting higher bond yields and suggesting that investors should be preparing for higher rates in most major markets. We are reflecting this scenario in our forecasts.

To be sure, our 1.75% forecast on a U.S. 10-year Treasury is paltry. After accounting for expected inflation of 2%, the yield is negative in real terms. Our yield forecast reflects not only continued uncertainty about the near-term and long-run effects of the coronavirus, but also some of the same macroeconomic trends that have pushed down on yields for the past four decades. These trends include demographic and technological changes, rising wealth and income inequality, slowing productivity growth, rising debt loads and, not least, credible inflation targeting by central banks. Most of these trends are likely to continue to hold down bond yields. Some of them, such as rising debt levels and inequality, have been exacerbated by the pandemic. Governments are exiting the pandemic with much higher debt-to-GDP loads and deficits, as some pandemic-era programs become permanent outlays. Over the long term, higher debt loads lower the expected growth and dynamism of an economy – weighing on bond yields.

Another factor keeping bond yields low is relatively poor economic outlooks in Europe and Japan, whose central banks are aggressively purchasing government bonds.

The European Central Bank (ECB) and the Bank of Japan (BOJ) are both purchasing vast amounts of government debt to bolster economic activity that is flagging because of structurally lower growth and inflation, and high government-debt levels. As a result, European and Japanese investors are investing more in foreign government-bond markets, such as the U.S. and Canada, depressing yields in places that would in isolation warrant higher yields.

Given our forecasts for higher bond yields, the outlook for government fixed income over the next 12 months is poor. We expect returns to be in the low single digits or even negative. Over the long term, we also expect bond yields will likely remain low. Nevertheless, low expected returns should not preclude holding government bonds as a safe asset in one's portfolio. Even with low yields, government bonds can still act as an important asset class offering ballast to a portfolio in case of a sell-off in equities and/or deterioration in the premium yields offered by corporate bonds.

While our forecasts are for higher yields a year from now, it is also true that yields are likely to remain much lower than historically was the case. Without a steady decline in bond yields (bond prices move inversely to yields), investors are unlikely to realize price appreciation from bonds and must be more careful about how they construct fixed-income portfolios.

To make up for projected declines in bond returns, investors have had to find new opportunities, one of which is in Chinese fixed income. These bonds offer higher yields and lower volatility than bonds in most developed markets and some emerging markets. Long closed off from foreign investors, the Chinese bond market is now the world's second-largest behind the U.S. and ahead of Japan. Chinese government bonds are slated for inclusion in the FTSE Russell World Government Bond Index (WGBI) over the next few years. Eventually, we expect China will be the sixth-largest member of the index, just behind Germany and ahead of the U.K. We have included Chinese bonds in several of our global fixed-income portfolios for several years in a bet that they will become more widely held. The fact that Chinese yields are relatively high makes them both a source of relatively attractive coupon income and an area of potential capital appreciation if their yields fall to levels more in line with other comparable markets.

Direction of interest rates

We expect no change to the fed funds rate over the next year, and see 10-year Treasury yields rising to 1.75%.

U.S. – The U.S. economy is so far powering through the negative impact that the delta variant is having on growth. Moreover, we expect growth to remain above trend for some time, likely accompanied for a time by inflation that exceeds the Fed's 2% target. Reflecting the progress made toward an economic recovery, we expect the Fed to begin slowing bond purchases early next year and completely stop before the end of 2022. Rate hikes, however, will likely not occur until 2023. Key to any eventual rate hike will be the performance of the labour market, which has some ways to go before satisfying the Federal Open Market Committee's (FOMC) goal of maximum employment.

As a reminder, the basis for Fed action has changed with the adoption of a policy that inflation must be sustainably above 2%, instead of being at that level at the time policy decisions are made. This approach is known as "average inflation targeting" and joins the policy that the unemployment rate be consistent with maximum employment. While the Fed has not defined what it means by maximum employment, it is fair to say it is well below July's unemployment rate of 5.4%.

Another concern for investors are impending changes to the FOMC's composition, which will make the body as a whole more likely to tighten monetary policy. The January changes involving the scheduled rotation of FOMCs voting members, coupled with the expected phasing-out of bond purchases, will tend to push up yields. Investors should also keep an eye on Fed Chair Jerome Powell, whose four-year term is up for renewal in February. President Biden is expected to rename Powell to the post, but could change his mind. We expect no change to the fed funds rate over the next year, and see 10-year Treasury yields rising to 1.75%.

We anticipate that the 10-year bond yield will rise to 1.50% sometime within the next year from about 1.20% currently.

Canada – In July, the Bank of Canada (BOC) fulfilled its intention to further reduce bond purchases, to $2 billion weekly from $3 billion, in light of the economic recovery. The BOC's decision to trim the pace of purchases was also influenced by a reduction in the government's financing needs. The BOC reiterated its commitment to hold the policy rate as low as possible until demand recovers and on the condition that inflation remain around 2 percent over time. Canadian inflation rose to its highest annual pace in two decades in July, reaching 3.7%. Like the Fed, the BOC continues to view the current jump in inflation as largely temporary. We expect to BOC to lower bond purchases to $1 billion a week in October, assuming the economy continues performing well, and to completely phase out quantitative easing early next year. Our earliest expectations for policy rates to rise is late 2022.

The yield on the Canadian 10-year bond fell over the past quarter as rising concerns about the delta variant and the global economic slowdown re-emerged. As a result, we believe that policymakers are more likely to hold off on raising rates until the near-term impact of these developments becomes clearer. Persistently higher inflation and a return to more consistent economic performance should lead to a modest upward trend in rates over the next year.

The BOC is scheduled to announce any changes to the way it makes policy decisions by the end of the year. The current policy mix targets inflation, and the outcome of recent reviews by the Fed and the European Central Bank (ECB) suggest that the BOC could add targets for the unemployment rate similar to the Fed. Other concerns that could be considered are financial stability, climate change, and income and wealth inequality.

Over the next 12 months we expect no change to the BOC's overnight rate, currently at 0.25%, and anticipate that the 10-year bond yield will rise to 1.50% sometime within the next year from about 1.20% currently.

We forecast the 10-year bond yield to be 0.10%, compared with about zero now.

Japan – We do not expect the Bank of Japan (BOJ) to undertake a major shift in policy over the next year. The policy rate remains -0.10% and the BOJ's target range for the 10-year Japanese Government Bond (JGB) yield is still centered on 0.00%. Japan's low vaccination rate has left the country struggling to contain the delta variant, weighing on economic activity. With the policy rate and long-term bond yields already near zero, the BOJ is unlikely to increase policy accommodation over the next year. Over the long term, Japanese yields should remain low thanks to persistently weak inflation and an aging and shrinking population that is weighing on potential growth. We expect the policy rate to be unchanged at -0.10% in a year's time and forecast the 10-year bond yield to be 0.10%, compared with about zero now.

We expect the 10-year gilt yield to rise to 0.80% over the next year from 0.50% currently.

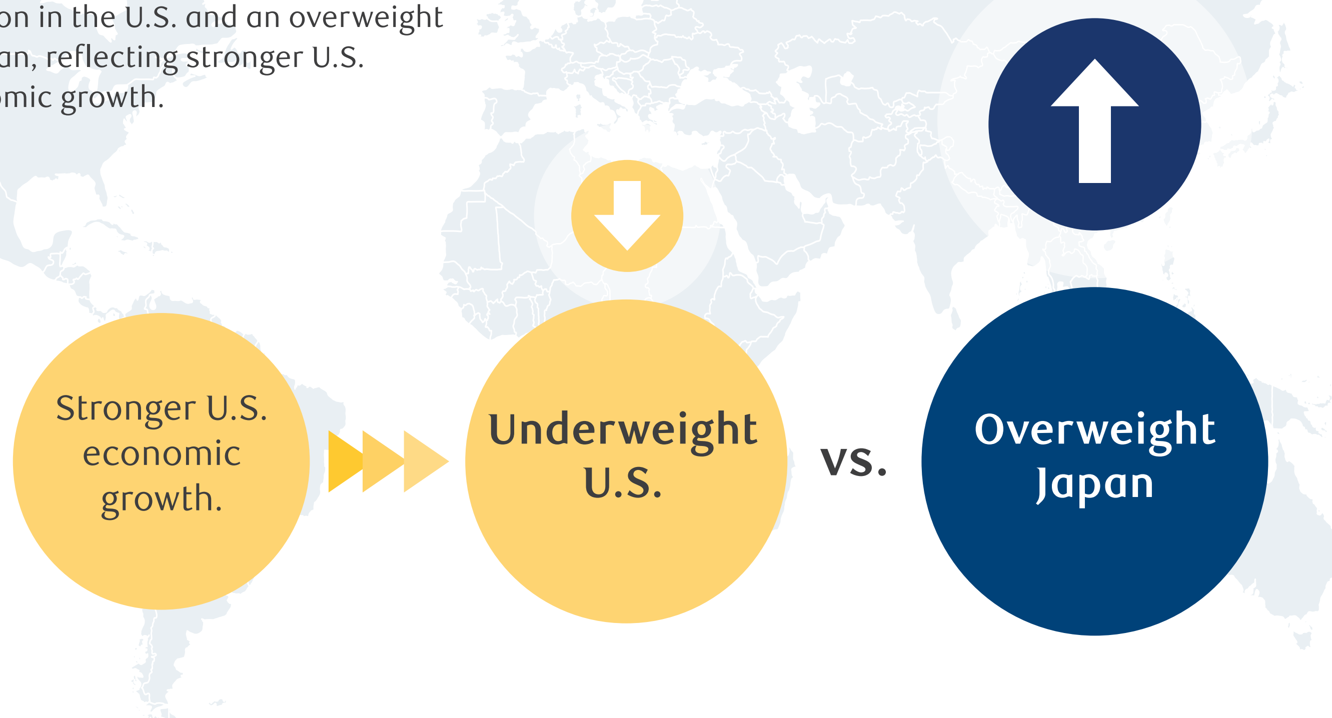
U.K. – We do not expect the Bank of England (BOE) to raise its policy rate over the next year. Nevertheless, confidence in the outlook for the U.K. economy through the medium term is running high enough that the BOE's Monetary Policy Committee (MPC) was recently emboldened to detail plans for reducing the pace of asset purchases and, eventually, embarking on a program to shrink its balance sheet. The MPC indicated that it would halt reinvestments of maturing securities once the policy rate reached 0.50% and actively sell assets once it reached 1.00%. We are skeptical that the BOE will follow through anytime soon with such an approach as it would put it at odds with most of its peers. Many investors share our skepticism: market indicators suggest that the policy rate will reach no higher than 0.70% over the next five years, falling short of the 1.00% that the BOE has set as the minimum rate for selling assets. Nevertheless, the U.K.'s recovery from the pandemic continues apace against a backdrop of higher-than-target inflation, paving the way for bond yields to rise over the year ahead. We expect no change to the policy rate. However, we expect the 10-year gilt yield to rise to 0.80% over the next year from 0.50% currently.

We expect to see the German 10-year bund yield rising to -0.25% in the year ahead from about -0.50% currently.

Eurozone – Apart from the BOJ, the ECB is likely to remain the central bank least likely to tighten monetary policy over the next few years. The ECB, having kept its policy rate in negative territory for more than five years, has been unwilling to cut the rate even further in response to the pandemic. Instead, policymakers have relied on asset purchases to keep borrowing costs low for governments and corporations, while vowing to keep rates on hold for ever-longer periods. Inflation in the Eurozone has risen much less markedly than in the U.S. or Canada, which we believe is due in part to the fact that COVID-related fiscal measures were less targeted at consumption. We expect no change to the ECB's overnight policy rate in the next 12 months and see the German 10-year bund yield rising to -0.25% in the year ahead from about -0.50% currently.

Regional recommendation

We expect bond yields to rise in most markets over the next 12 months. Our recommendations are an underweight position in the U.S. and an overweight in Japan, reflecting stronger U.S. economic growth.



Interest rate forecast: 12-month horizon

Total Return calculation: September 1, 2021 – September 1, 2022

U.S.

	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	0.13%	0.65%	1.25%	1.75%	2.35%	(1.56%)
Change to prev. quarter	0.00%	0.35%	0.25%	0.00%	(0.05%)	
High	0.38%	1.25%	1.75%	2.25%	2.80%	(4.56%)
Low	0.13%	0.13%	0.25%	0.75%	1.25%	5.72%
Expected Total Return US$ hedged: (1.1%)						

Germany

	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	(0.50%)	(0.40%)	(0.40%)	(0.25%)	0.15%	(1.04%)
Change to prev. quarter	0.00%	0.10%	0.10%	0.00%	(0.15%)	
High	(0.50%)	(0.25%)	(0.20%)	0.05%	0.40%	(3.92%)
Low	(0.50%)	(0.60%)	(0.70%)	(0.75%)	(0.35%)	5.02%
Expected Total Return US$ hedged: 0.0%%						

Japan

	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	(0.10%)	(0.10%)	(0.50%)	0.10%	0.75%	(0.38%)
Change to prev. quarter	0.00%	0.00%	(0.45%)	0.00%	0.10%	
High	(0.10%)	(0.05%)	0.00%	0.25%	0.85%	(2.32%)
Low	(0.10%)	(0.10%)	(0.10%)	(0.10%)	0.40%	4.65%
Expected Total Return US$ hedged: 0.1%						

Canada

	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	0.25%	0.70%	1.25%	1.50%	2.00%	(0.91%)
Change to prev. quarter	0.00%	0.20%	0.25%	0.00%	0.00%	
High	0.50%	1.00%	1.50%	2.00%	2.40%	(4.12%)
Low	0.25%	0.25%	0.50%	0.75%	1.25%	5.75%
Expected Total Return US$ hedged: (0.6%)						

U.K.

	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	0.10%	0.40%	0.60%	0.80%	1.10%	(0.15%)
Change to prev. quarter	0.00%	0.20%	0.20%	0.10%	(0.20%)	
High	0.35%	0.80%	1.00%	1.20%	1.50%	(6.37%)
Low	0.10%	0.20%	0.30%	0.50%	0.90%	3.36%
Expected Total Return US$ hedged: (0.4%)						

Source: RBC GAM

Currency markets

Cyclical currencies to fare best as U.S. dollar weakens

Dagmara Fijalkowski, MBA, CFA
Head, Global Fixed Income & Currencies
RBC Global Asset Management Inc.

Daniel Mitchell, CFA
Portfolio Manager
RBC Global Asset Management Inc.

Recent strength in the U.S. dollar has not swayed us from our bearish outlook. The greenback is still in the early stages of a multi-year downtrend, and this year's resilience stems largely from short-term factors that will likely fade over the coming months. However, gains against the dollar over the next year are unlikely to be as broad-based as they were over the past 18 months. We have tempered our optimism on the low-yielding euro, and remain positive on commodity currencies and those for which central banks are raising interest rates.

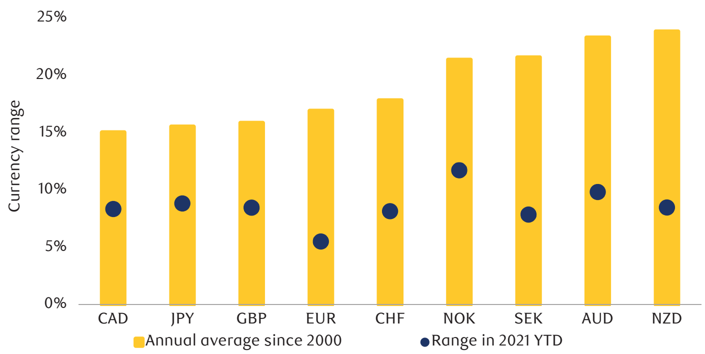
The U.S. dollar has rallied by 2.6% against a basket of developed-market currencies since the beginning of the year, which is notable for the fact that the gain has been so small. It is not unusual for currencies to fluctuate by at least 15% in a given year, and yet most currencies are posting ranges that are much smaller than that so far in 2021 (Exhibit 1). The 4% range in the U.S. dollar (exhibits 2 and 3) is particularly tight and results in a less active foreign-exchange market given that fluctuations in the greenback are important in dictating how other currencies perform.

For most of 2020, the influence of a falling dollar was reflected in generally rising prices for commodities and other risky assets, and at the end of last year, a consensus had formed that the dollar had further to fall. The greenback's gain this year, however small, has therefore felt larger than the actual 2.6% rally.

Our view is that the U.S. dollar is still in the early stages of a longer-term bear market (Exhibit 4). The currency remains overvalued based on purchasing power parity models even after last year's decline, and other long-term factors continue to suggest that more weakness lies ahead. U.S.-dollar declines are associated with global economic expansions as capital is redirected abroad in search of higher returns. This flow is likely to be magnified by the abundance of liquidity in the U.S. money markets and the low level of U.S. bond yields, particularly after adjusting for inflation.

Short-term U.S.-dollar rallies that occur in the midst of a bear market are not uncommon (Exhibit 5), and the limited size of the current rally leaves us confident in our view for a continuing bear market. The dollar's resilience amid these longer-term headwinds is due largely to temporary factors that are unlikely to persist through our forecast horizon.

Exhibit 1: Unusually tight ranges in 2021

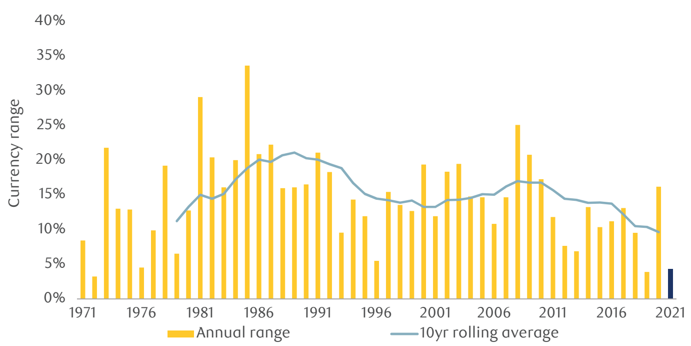


Note: As at Jul. 30, 2021. Source: Bloomberg, RBC GAM

Exhibit 2: U.S dollar remains in tight range

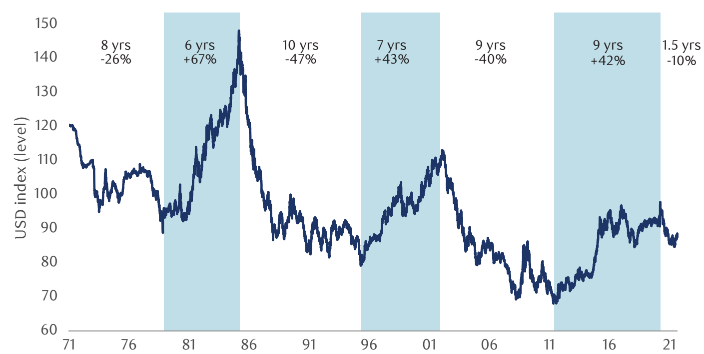
Note: As at Aug. 31, 2021. Source: Bloomberg, RBC GAM

Exhibit 3: Low volatility in U.S. dollar unlikely to last



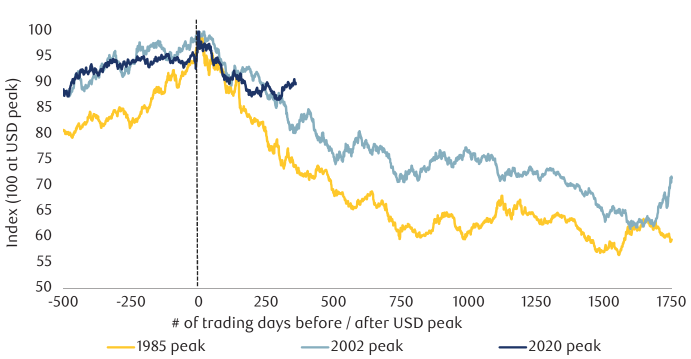
Note: USD index comprised of DXY index prior to 2015 and BBDXY from 2015 onwards. As at Aug. 30, 2021. Source: Bloomberg, RBC GAM

Exhibit 4: U.S. trade-weighted dollar



Note: As at Aug. 27, 2021. Source: Bloomberg, RBC GAM

Exhibit 5: U.S. dollar bear-market roadmap

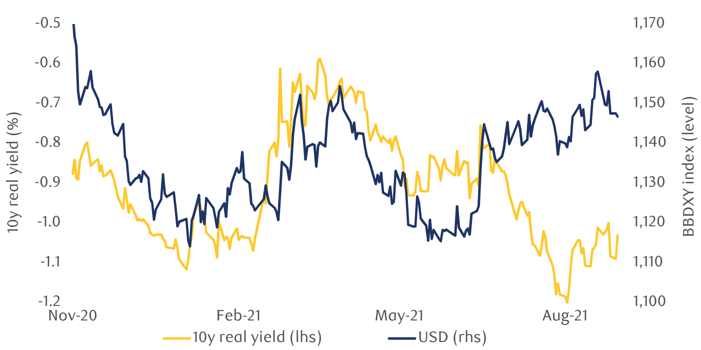


Note: As at Aug. 27, 2021. Source: Bloomberg, RBC GAM

These transient factors include:

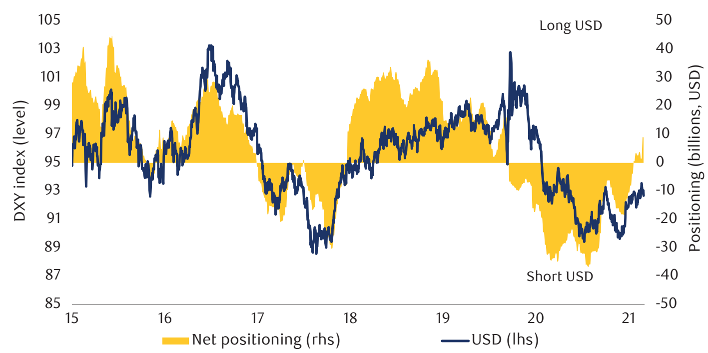
1. An unwinding of bets that the U.S. dollar would continue to fall into 2021. Traders had come to expect the dollar to trade in tandem with U.S. bond yields (Exhibit 6) – a bet that the U.S. Federal Reserve (Fed) would not be eager to unwind stimulus, that cyclical stocks would outperform and that long-term bond yields would rise faster than short-term yields (a steepening yield curve). The fact that the greenback rose during a time when longer-term interest rates were falling caused some initial confusion because falling yields and a stronger dollar are normally a product of capital seeking safer havens – and a flight to safety was not consistent with equity markets pushing to all-time highs. The adjustment to positioning that caused this divergence was temporary, however, and currency markets are now much more neutrally positioned (Exhibit 7).

Exhibit 6: Yields and the U.S. dollar



Note: As at Aug. 30, 2021. Source: Bloomberg, RBC GAM

Exhibit 7: Neutral dollar positioning



Note: As at Aug. 27, 2021. Source: CFTC, Bloomberg, RBC GAM

2. Concerns about the spread of the delta variant dented confidence in the global economic recovery and made U.S. investors more reluctant to allocate funds abroad. While there exists a huge disparity in each country's ability to withstand the spread of the virus, we have seen encouraging signs of limited hospitalizations and dramatically fewer deaths in highly vaccinated regions. To this end, lockdowns should be less severe and the economic hit experienced from the current wave should not be enough to derail the global recovery. Emerging-market assets remain attractive, particularly those in high-growth and high-yielding regions.

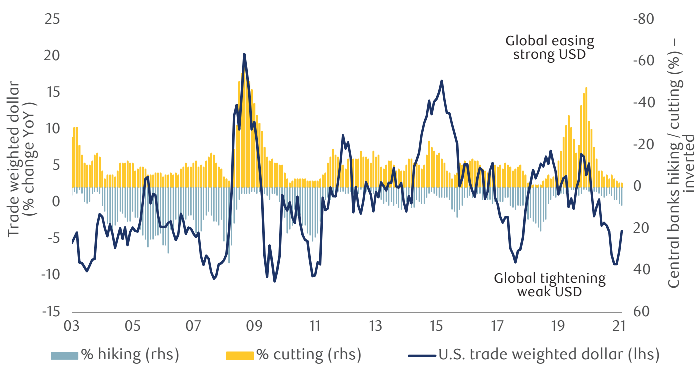
3. Debate surrounding the summertime rise in prices for goods also contributed to a stronger dollar, largely from speculation that the Fed might soon begin to tighten monetary policy. We are skeptical that this bump in inflation will continue to support the dollar. For one thing, the Fed has said it believes that today's higher inflation is "transitory" – the effect of short-term shipping and production bottlenecks associated with the pandemic as well as from a reversal of last year's commodity gains. Fed Chair Powell has argued for patience in allowing these cost pressures to subside and to support continued gains in the labour market, and any moves to scale back monetary easing will be tentative. Second, while most investors are focused on when the Fed will begin to reduce its US$120-billion-a-month pace of bond purchases, we argue that it's the timing of interest-rate hikes that matters much more. Not only are rate increases likely a distant prospect (markets expect the first one in March 2023), but the odds of a hike even that soon are questionable given the Fed's intention to fully wind down asset purchases prior to raising rates while ensuring that asset markets aren't disrupted as stimulus is withdrawn.

With the Fed being top of mind for many traders, it's natural that spreads between short-term interest rates among regions (a proxy for differences in monetary-policy expectations) are playing a greater role in driving currencies. Indeed, recent hints by the European Central Bank (ECB) of an extended period of low rates has weighed on the euro and is one reason we've dialed down our optimism on the single currency. At the same time, monetary authorities in several countries whose currencies are tied to strong global growth (Norway, Canada and New Zealand) have broadcast their intentions to hike sooner and more aggressively than markets currently expect from the Fed. Interest-rate hikes have already materialized in several emerging-market countries, and should keep downward pressure on the U.S. dollar (Exhibit 8). Policy rates in Russia have been raised by 2.25 percentage points, for example, and in Brazil by 3.25 points. Central banks in Chile, South Korea, Mexico, Peru, Hungary and Czechia have been raising interest rates as well.

Higher bond yields and the capital flows they attract are not the only reasons we like emerging-market and cyclical currencies. These currencies are undervalued on multiple measures and under-owned after a difficult year. They also carry a higher sensitivity to commodities and global economic activity at a time when governments are learning how to properly lift lockdowns. While it's true that emerging markets have been slower to vaccinate their populations, research by Goldman Sachs indicates that they may have equally high levels of immunity (Exhibit 9) owing to antibodies developed during prior waves and a population with greater natural resistance to the virus. Moreover, the economic damage in many emerging markets was cushioned in part by a shift in global demand toward goods, many of which are produced in developing countries.

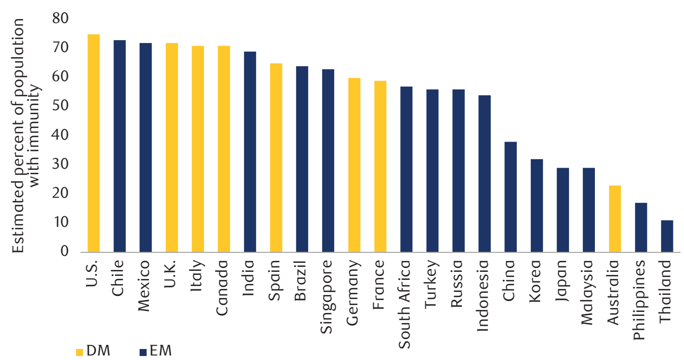
That said, we are being more selective in our approach to investing in emerging markets and expect outperformance from currencies with hawkish central banks, strong fiscal dynamics and higher sensitivity to global economic activity.

Exhibit 8: More emerging-market central banks are now hiking



Note: Hiking / cutting is 3m rolling average. As at Jul. 30, 2021.
Source: TD Securities

Exhibit 9: Emerging markets have relatively high levels of immunity



Note: As at Jul. 26, 2021. Source: Goldman Sachs

Euro

The euro has underperformed our expectations over the past few months, unable to push beyond January's 1.2350 high and falling to 1.1700 in mid-August. Aside from temporary U.S.-dollar strength, another reason for the euro's recent weakness is the ECB's differing approach to monetary policy compared with central banks in the U.S. and Canada. While the Fed has started a discussion on reducing bond purchases, the ECB is likely to continue with asset purchases for the foreseeable future. As part of a recent strategic review, the ECB also unveiled a set of tough-to-meet criteria (Exhibit 10) guiding any eventual increase in European interest rates. For context, the harmonized CPI index preferred by policymakers has exceeded 2% only a handful of times since 2012. Moreover, there is sufficient leeway in how these rules are interpreted that the bank could keep policy easy even if inflation were to rise.

Even so, the prevailing pessimism on the euro seems to us to be inconsistent with economic developments in the Eurozone. According to Citibank indexes, for example, economic data in Europe has been more positive relative to expectations than it has in the U.S. (Exhibit 11). The currency has decoupled from this economic indicator, perhaps for fear that the delta variant could cause a reversal of reopening efforts in Europe. To date, however, the more infectious strain hasn't kept Europeans indoors and nor has it held back consumer spending – Google's mobility data show a quicker return to normal in Europe than the U.S. since April (Exhibit 12).

Balancing domestic developments with the more dovish ECB stance, we have trimmed our 12-month forecast for the euro versus the greenback to US$1.27 from US$1.30.

Exhibit 10: ECB's new criteria for rate hikes

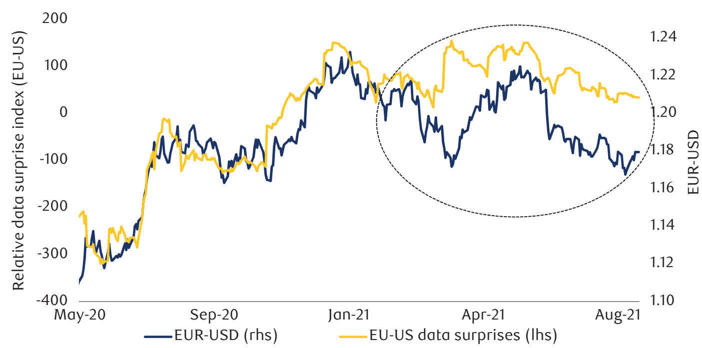
Condition A: Inflation reaches 2% by midpoint of forecast horizon

Condition B: Inflation sustainably remains at 2% durably for the latter half of forecast horizon

Condition C: Underlying inflation dynamics consistent with stable inflation at 2% beyond forecast horizon

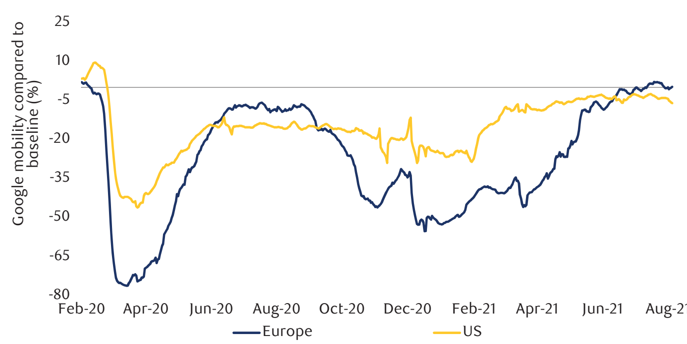
Source: RBC GAM

Exhibit 11: Euro disconnected from economic data



Note: As at Aug. 30, 2021. Source: Bloomberg, Citigroup, RBC GAM

Exhibit 12: Eurozone mobility back to pre-COVID levels



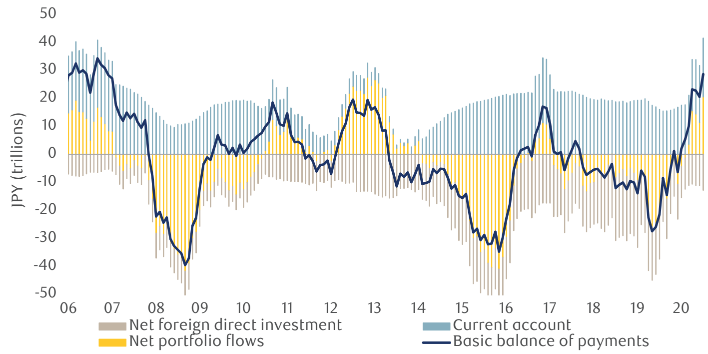
Note: Europe is an average of Germany, France, Austria, Italy, Spain, Belgium and Netherlands. As at Aug. 25, 2021. Source: Google, RBC GAM

Japanese yen

Japan has enjoyed a stable current-account surplus for years, a positive inflow that is only partially offset by capital leaving the country to finance foreign direct investment (Exhibit 13). The swing factor in the balance of payments comes in the form of newfound demand for Japanese assets. Domestic investors seem more enthusiastic about Japanese equities, and foreigners are keen on the country's bonds, though a portion of the bond flows is currency-hedged. The inflows coincide with news that the US$1.7 trillion Government Pension Investment Fund (GPIF) has completed its shift into global assets from domestic bonds, removing a key negative for the yen.

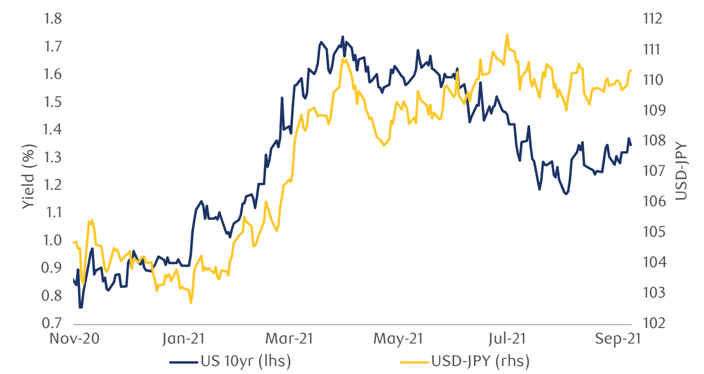
The yen's performance has for now deviated from what we would expect given bond-yield differences and other factors that usually determine its direction. The gap between U.S. bond yields and where they suggest the yen should trade (Exhibit 14) is particularly wide and we look for some yen strength as the two converge. Our forecast for the yen to trade at 103 per dollar remains unchanged from last quarter.

Exhibit 13: Japan's basic balance of payments



Note: As at Jun. 30, 2021. Source: Bank of Japan, RBC GAM

Exhibit 14: U.S. yields versus U.S. dollar-yen exchange rate



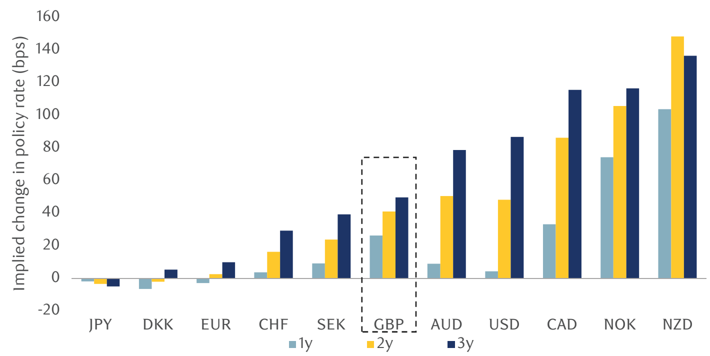
Note: As at Sep. 8, 2021. Source: Bloomberg, RBC GAM

British pound

The British pound has not been among our favourite currencies over the past few years due to Brexit uncertainty, a sizable current-account deficit and a lack of competitiveness relative to its largest trading partners. This pessimism has softened, perhaps more from our bearish outlook on the U.S. dollar than for any U.K.-specific reasons. The macroeconomic landscape continues to suggest that the pound will underperform versus the euro, the yen and cyclical currencies – whether because of muted expectations for economic growth or from the slow pace at which interest rates are expected to rise. It is possible that the Bank of England will hike rates as early as 2022, although we believe that any subsequent hikes would be slow to materialize (Exhibit 15). We are also mindful of tensions with Europe over the implementation of a post-Brexit arrangement concerning Northern Ireland and of another possible referendum on Scottish independence.

Our forecast is that the pound will appreciate against the U.S. dollar within the next year to US$1.40 from US$1.38 currently.

Exhibit 15: Slower and smaller rate hikes from Bank of England

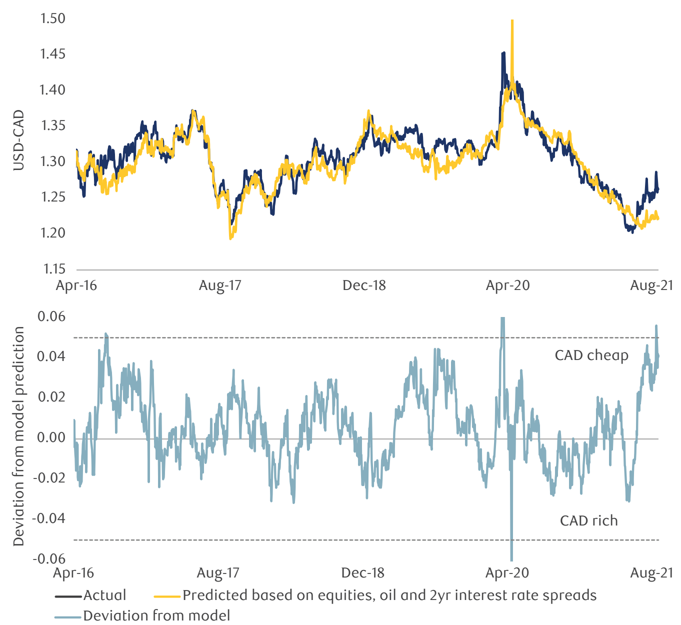


Note: As at Aug. 30, 2021. Source: Bloomberg, RBC GAM

Canadian dollar

The Canadian dollar has fallen 5% since the beginning of June. Weaker global economic data and broad U.S.-dollar strength are partly to blame for the depreciation, though can't fully explain it. Even with the decline, the Canadian dollar is the best-performing G10 currency this year, and statistical models (Exhibit 16) suggest the currency should strengthen if it is to realign with the factors that tend to influence its value (equities, oil and 2-year interest-rate spreads). Indeed, the resilience of equity markets and commodities amid the surge in the delta variant indicates that wobbles in fixed-income and foreign-exchange markets were driven by investors unwinding bets that the loonie would rise rather than anything fundamental. The snap-back in commodity currencies has already begun, a trend that will be further supported by relatively hawkish monetary policy in Norway, New Zealand and Canada, where earlier and more aggressive rate hikes are expected.

Exhibit 16: Canadian dollar has deviated from short-term models

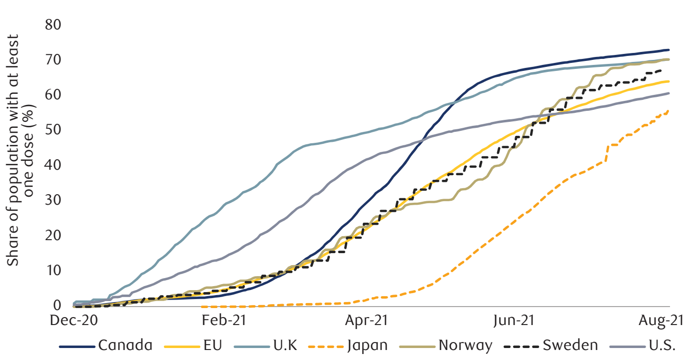


Note: As at Aug. 27, 2021. Source: Bloomberg, RBC GAM

The following factors should keep the currency relatively strong in 2022:

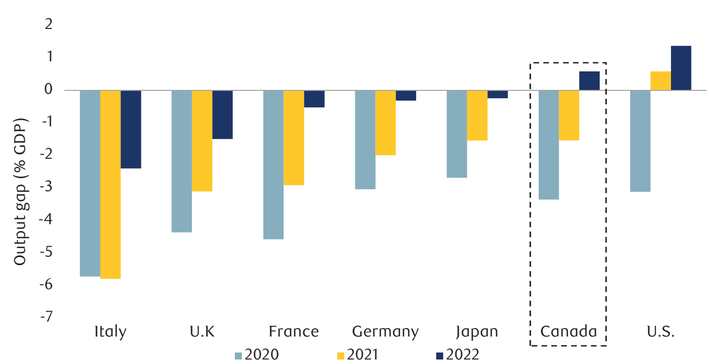
- Canada's impressive record of vaccinating its population (Exhibit 17) means that there has been a relatively small number of COVID-19 cases during this most recent wave, and bodes well for the future.
- Labour markets in Canada are closer to reaching pre-pandemic levels than in the U.S., and the IMF expects the output gap to close more quickly in Canada than in other major developed economies (Exhibit 18).
- A reduction in bond purchases by the Bank of Canada has investors expecting rate hikes in Canada sooner than in many other developed-market countries.
- A boom in residential investment supports economic activity amid a long-term decline in business investment.
- Immigration that is set to accelerate with the reopening of borders.
- News of renewed investment activity in stalled pipeline and infrastructure projects such as the Trans-Mountain pipeline and Muskrat Falls hydro-electric dam.

Exhibit 17: Vaccination rates in Canada remain high



Note: As at Aug. 29, 2021. Source: Our world in data, RBC GAM

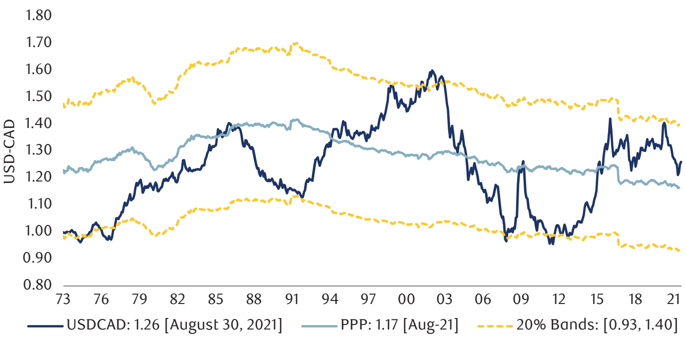
Exhibit 18: Canadian output gap to close before many developed-market economies



Note: As at Apr. 26, 2021. Source: IMF World Economic Outlook, RBC GAM

The Canadian dollar remains undervalued (Exhibit 19) based on purchasing power and we expect the loonie to appreciate against most major currencies in the coming year. U.S.-dollar weakness – though helpful – will not be the only force driving loonie strength. We expect the market to pay more heed to factors that tend to support the Canadian dollar at a time when bets on Canadian-dollar strength have been pared. Our forecast is for the loonie to trade at $1.15 per U.S. dollar in a year's time. A move of this magnitude might seem implausible from the current level of $1.25, but it is one that we think is reasonable given an overvalued U.S. dollar, a Fed that will be slow to tighten monetary policy and global economic strength that continues to support commodity prices.

Exhibit 19: Purchasing power parity valuation



Note: As at Aug. 30, 2021. Source: Bloomberg, RBC GAM

Conclusion

Support from a few short-term themes helped the U.S. dollar trade sideways this year within a very tight 4% band. We believe that the greenback remains in a longer-term downtrend, however, and that further weakness will persist in the years ahead. The dollar decline should be most helpful for cyclical currencies that benefit from rising commodity prices and the ongoing global economic reopening, and we are particularly positive on those currencies with central banks that will likely hike interest rates faster than the Fed. While our optimism on the euro has been tempered slightly, we remain positive on other G10 and emerging-market currencies.

Regional Outlook – U.S.

Brad Willock, CFA
V.P. & Senior Portfolio Manager
RBC Global Asset Management Inc.

The S&P 500 Index generated an above-average return of 8.0% during the three-month period ended August 31, 2021, driven by central-bank intervention, generous government stimulus and a robust earnings recovery. The S&P 500 is now up over 20% this year at more than double the March 2020 low. It has been an extraordinary period and provides an ideal time to evaluate where we stand.

The first thing to recognize is that we are not out of the pandemic. In fact, it appears highly likely that COVID-19 will be with us for the foreseeable future. The recent surge in U.S. cases has led to a significant increase in hospitalizations in many southern states, resulting in a drop in economic activity in COVID-19-affected industries such as dining, hotels, casinos and entertainment venues. Fortunately, the spike in cases has not been as severe in high-GDP states in the Northeast, and economic activity in that region has offset most of the drop elsewhere to the degree that aggregate GDP data continues to look quite good. The latest data from the hardest hit states suggests cases may be in the process of peaking, and we should expect pressure on the health-care system to subside this fall depending on how much the situation deteriorates as kids return to school. Given the extremely high transmissibility of the delta variant, it is likely we are all going to acquire immunity one way or the other. For equity investors, the bottom line is that unless things get substantially worse on the COVID-19 front, we are unlikely to see widespread economic lockdowns in the U.S.

In terms of monetary policy, the U.S. Federal Reserve (Fed) has told investors its will likely begin reducing its bond purchases later this year, but that policy rates are unlikely to rise until late next year or more likely sometime in 2023. The Fed is focused on achieving maximum employment and seems convinced that the recent jump in inflation should ease as supply-chain congestion is relieved and demand shifts from goods to services. Employment is expected to continue to improve as virus fears wane, kids return to classes and generous unemployment benefits come to an end. While there are more jobs available than there are people looking for work, it may take some time for the Fed's goal of maximum employment to be reached. For stock investors, the longer the Fed delays raising rates, the better.

Regarding fiscal policy, Congress has a busy few months ahead. There are two major bills being considered, including a US$550 billion infrastructure measure, which has bipartisan support, and the Biden administration's US$3.5 trillion budget proposal to fund spending on health care, education and climate-change initiatives paid for in part by tax increases on corporations and high-income earners.

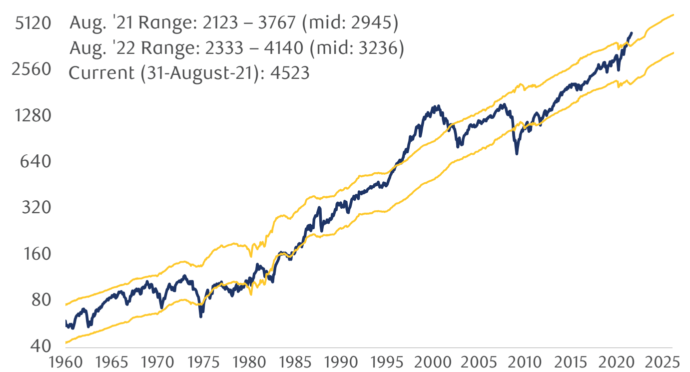
United States – Recommended sector weights

	S&P 500	Underweight / Overweight
Energy	2.4%	-1.0%
Materials	2.5%	-0.5%
Industrials	8.2%	0.3%
Consumer discretionary	11.9%	0.1%
Consumer staples	5.8%	-0.3%
Health care	13.5%	0.9%
Financials	11.0%	0.1%
Information technology	28.0%	1.0%
Communication services	11.4%	0.1%
Utilities	2.5%	-0.4%
Real estate	2.7%	-0.3%

Note: As of Aug. 2021. Source: RBC GAM

The second bill is supported only by Democrats and faces a tough road. In addition, Congress must agree to fund the government for the next fiscal year beginning October 1 or face shutdown, and to raise the debt ceiling to avoid a default, sometime in early November. The timelines are tight and the politics are messy. Republicans are against raising taxes and think the size of the budget proposal is far too high. Democrats want to go big while they have majorities in the House of Representatives and the Senate. In the end, we think the administration's budget proposal will get cut back significantly in exchange for Republican support on the other measures. Importantly, the market is not pricing in the likely tax increases included in the budget package, which we estimate would result in a 5%-8% reduction in S&P 500 earnings in 2022. We expect financial markets to be volatile over the next few months and intend to use any market decline to increase our exposure.

S&P 500 equilibrium
Normalized earning and valuations



Source: RBC GAM

The S&P 500's steady climb over the past 10 months has largely obscured what has been happening at the sector and individual stock levels. When the pandemic started in early 2020, defensive stocks and stocks that stood to benefit from the pandemic, largely in the Information Technology sector, outperformed. Then, in the fall of 2020, Pfizer announced successful clinical-trial results for its COVID-19 vaccine and the hope of getting back to normal spawned a rally in retailers, restaurants, hotels and banks that lasted through the end of March 2021. At that point, investor optimism was high and "getting back to normal" was mostly priced into stocks. Meanwhile, the delta variant began to make its way into the U.S., resulting in a surge in cases this summer and hindering the recovery. A market rotation back into Information Technology and Communication Services ensued, and investors also moved into defensive sectors like REITs and Health Care. In the near term, banks and commodity-related stocks are likely to outperform as long as the impact of the delta variant doesn't worsen. However, in the longer term, most of our portfolios are positioned for the post-pandemic era. We are not sure exactly what the future holds, but we are pretty sure that exposure to stocks related to climate change, digitization, work-from-home, health and wellness, and infrastructure improvement are sure to benefit from tailwinds for many years.

Regional Outlook – Canada

Sarah Neilson, CFA
Portfolio Manager
RBC Global Asset Management Inc.

Irene Fernando, CFA
Portfolio Manager
RBC Global Asset Management Inc.

The S&P/TSX Composite Index climbed 5.0%, reaching new highs in the three-month period. In U.S.-dollar terms, however, the S&P/TSX was flat due to the strong performance of the U.S. dollar. Global equity markets continued to reflect optimism about the progress of COVID-19 vaccinations in much of the developed world, fueling economic growth and strong corporate earnings. The S&P 500 Index returned 8.0%, and the MSCI World Index was up 5.9% during the period.

Commodities such as copper, crude oil and lumber had extremely strong starts to the year, though prices fell back as an increase in COVID-19 cases in the developed world suggested that the economic outlook was not as robust as had been expected. In Canada, areas of the stock market that are less exposed to the pace of economic growth – Consumer Staples, telecommunications, REITs and Utilities – outperformed and offset weakness in the Materials and Energy sectors. The Information Technology sector, now one of the largest in the S&P/TSX in terms of market capitalization, was a standout, climbing almost a third over the three-month period supported by high valuations and forecasts that demand for new technology will remain strong beyond the pandemic.

Lately, growing uncertainty about the impact of the COVID-19 delta variant has caused concern about the pace of the recovery and pushed down interest rates. Inflation expectations are also a concern, although to a lesser extent. Any persistence in inflation could prompt the Bank of Canada (BOC) to raise benchmark interest rates sooner than it would like and weigh on corporate profit margins, both of which could limit equity returns.

Canada's federal election will be decided September 20. Fiscal policy, climate change and energy policy, labour availability, housing affordability and proposed increases in corporate taxes are the main issues being debated. The outcome of the election could bring some uncertainty for profits. For one thing, the Liberal Party has proposed an increase in taxes on large financial institutions.

The summer started with the reopening of many provinces from spring-time COVID-related lockdowns. As a result, economic growth resumed due to strong consumer demand, further supported by continued strength in housing. Economic momentum should continue in the second half of this year, albeit at a slower rate than we had expected due to the delta variant. Canada's relatively high vaccination rates should help limit restrictions as a new surge in cases arrives in the fall. The BOC expects consumers and businesses to continue to accelerate spending but remains cautious about the pace of the economic recovery. The BOC forecasts 2021 economic growth of 6%, and 4.5% in 2022.

Canada – Recommended sector weights

Sector	S&P/TSX Composite	Recommended weight
Energy	12.1%	-0.6%
Materials	11.5%	-0.5%
Industrials	12.2%	0.3%
Consumer discretionary	3.7%	0.3%
Consumer staples	3.7%	0.8%
Health care	1.1%	-0.4%
Financials	31.1%	0.9%
Information technology	12.0%	-1.2%
Communication services	4.9%	0.6%
Utilities	4.6%	-0.3%
Real estate	3.1%	0.2%

-1.5% -1.0% -0.5% 0.0% 0.5% 1.0% 1.5%

Underweight | Overweight

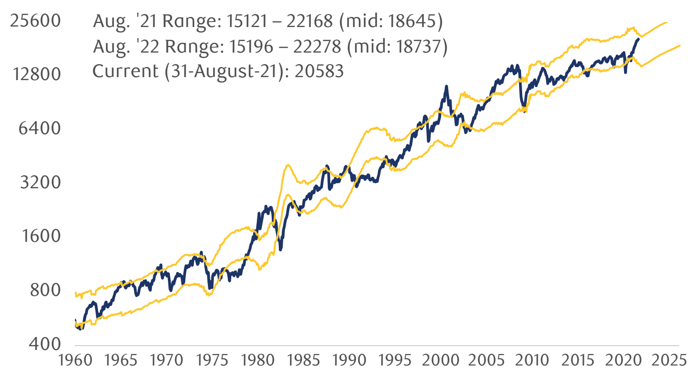
Note: As of Aug. 2021. Source: RBC GAM

The pace of housing-price appreciation slowed during the summer after soaring in the wake of the pandemic. A lack of supply is one of the major factors limiting home resales while low borrowing rates are supporting prices, especially for detached homes.

The outlook for corporate earnings continues to improve as companies benefit from strong revenue growth. The consensus estimate for S&P/TSX earnings in 2021 has been raised, with profits on pace to climb 56% and exceed pre-pandemic levels. Earnings growth in 2022 is forecast at 6%. Earnings for the first half of the year exceeded analysts' expectations in most sectors, and the biggest contributions to earnings growth for the year are expected to come from Energy, Financials, Materials and Industrials. We anticipate that with the economic recovery from the pandemic progressing into next year, earnings growth will be driven by the Industrials, Energy and Consumer Discretionary sectors.

S&P/TSX Composite Equilibrium

Normalized earnings and valuations



Source: RBC GAM

The performance of the S&P/TSX this year has been largely driven by expectations of faster profit growth, while valuations have stagnated. Valuations are slightly higher than the historical average, with the S&P/TSX forward price-to-earnings multiple at 15.7, a significant discount to the S&P 500's 21.1. The substantial weighting of lower valued Financials and Energy stocks in the S&P/TSX helps explain the valuation gap between the markets.

The operating environment for Canadian banks is improving. Loan growth and consumer spending are gaining momentum as the economy reopens, which has helped offset the impact of low interest rates in Canada and the U.S. Credit quality remains pristine. We expect earnings to further benefit as banks reverse provisions that had been set aside to cover bad loans when the pandemic took hold. Banks are also sitting on historically high capital levels due to restrictions imposed last year, leading to investor expectations of accelerated dividend growth and buybacks when the measures are lifted. Over the medium term, we anticipate an improving set-up for the sector as business growth accelerates, interest rates increase from historically low levels, and the benefits of cost-cutting and technology investment are recognized.

Oil prices have remained steady, supported by OPEC's pledge to link increases in supply to demand that was bolstered by rising personal mobility over the summer. With supply expected to grow at a measured pace, evidence of robust crude-oil demand growth is critical to sustaining prices above the US$60-per-barrel level. At current prices for crude oil and natural gas, Canadian energy producers have begun to generate considerable free cash flow. Many management teams recently reiterated their intention to direct these excess funds to debt reduction, shareholder returns and efforts to reduce carbon emissions rather than invest in large-scale production growth. This approach should benefit equity holders over time.

Climate change is of growing importance to consumers and investors. Policies regarding emissions-reduction targets and increased disclosure of climate-related data are gaining in momentum and significance. More corporations are pledging to align with global efforts to reduce greenhouse gases and other environmental goals. We are in the early stages of assessing the effect on profitability, capital costs, revenue opportunities and growth options arising from environmental concerns.

Regional Outlook – Europe

Elma de Kuiper
Portfolio Manager,
RBC Global Asset Management (UK) Limited

European equities have continued their upward trajectory, with the EuroStoxx 600 Index gaining 6.0% in local currency during the three months ended August 31, 2021. These returns mark a slowdown from the prior quarter but nevertheless represent strong growth for the region.

The backdrop for European equities is somewhat mixed. Certain leading indicators in Europe have peaked, but earnings estimates are still being raised and there is good policy support, both fiscal and monetary. Rates of vaccination for COVID-19 are better than expected and the protection afforded against hospitalization means that countries across Europe are experiencing the start of what feels like a sustained opening-up of borders for the first time since the pandemic emerged.

In our report in May of this year, we remarked that the style characteristics of Europe's stock-market performance have followed a classic cyclical recovery path. Value stocks had outperformed the growth part of the market significantly since November 2020, when the first conclusive evidence of effective COVID-19 vaccines accelerated the timetable for economic recovery. We predicted that the bulk of this move had taken place at that time and rotated back into our favoured high-quality companies.

Indeed, the waning in the outperformance of value stocks appears to be exactly what has happened. Since May, value stocks have returned 2.4%, underperforming the 8.9% gain for growth stocks, with Information Technology the strongest-performing sector in Europe, up 19.1%. The underperformance of value stocks is a natural development after a period of investor exuberance. We have entered the "slowdown" phase of the style cycle, and should now expect stocks of companies exhibiting growth and quality to outperform value. In this environment, large-cap stocks will benefit from rising momentum and should outperform smaller-cap stocks.

Today's environment might not feel like a "slowdown" in the economy, but it is consistent with past cycles characterized by economic growth that has peaked. Certain leading indicators are in line with this backdrop. For instance, M1, a narrow measure of money supply and reliable indicator of GDP growth and business conditions, peaked last month. Similarly, the economic surprise index is the lowest it has been since January 2020 after a medium-term high in October and a short-term high in April 2021.

Growth slowdowns closely follow what were in retrospect cyclical tops in economic output and profits. At these times, large numbers of companies will typically report financial results that beat analysts' expectations, but their shares will fall back. We have started to see this happen. While the picture we are painting of a pessimistic outlook sounds at odds with strong earnings, it is in fact the expected combination. We therefore anticipate that equity-market breadth will continue to retreat.

Europe – Recommended sector weights

	MSCI Europe	
Energy	4.1%	-1.6%
Materials	8.1%	-0.6%
Industrials	15.1%	0.9%
Consumer discretionary	11.7%	1.0%
Consumer staples	12.4%	0.9%
Health care	14.6%	-0.3%
Financials	15.5%	-0.2%
Information technology	9.1%	1.4%
Communication services	3.8%	-0.6%
Utilities	4.2%	-0.7%
Real estate	1.3%	0.0%

-2.0% -1.5% -1.0% -0.5% 0.0% 0.5% 1.0% 1.5% 2.0%

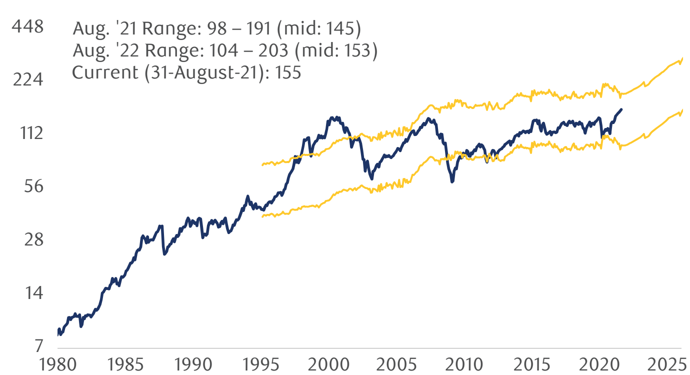
Underweight Overweight

Note: As of Aug. 2021. Source: RBC GAM

“Environmental, social and governance (ESG) themes are increasingly important for equity-market investors and it is appropriate to address developments on this front in Europe, the pioneer in the transition to cleaner energy and now the global leader in this area.”

MSCI Europe Index Equilibrium

Normalized earnings and valuations



Source: RBC GAM

What was unusual about the 2020 recession is that it was the first one in which European dividends per share fell more than earnings per share, reflecting in part governments' pressure on companies to scale back payouts after accepting taxpayer support.

Looking ahead, we expect European buyback activity to rise sharply, reverting to the pre-pandemic trend in which European companies were already pivoting to stock repurchases at the expense of dividends. In 2019, buybacks represented a record 25% of all shareholder cash returns. Moreover, shares of companies devoting more resources to buybacks have during the past five years tended to perform better than those focused on keeping their dividends high and/or boosting payout ratios. The benign earnings-growth backdrop, which is supportive of a rebound in European profits in the medium term, should correlate with a reinstatement of cash distributions, and consensus estimates suggest that European dividends per share will be back to pre-COVID levels by late 2022.

Environmental, social and governance (ESG) themes are increasingly important for equity-market investors and it is appropriate to address developments on this front in Europe, the pioneer in the transition to cleaner energy and now the global leader in this area. We believe that 'tail risk' events - occurrences that are unlikely but are an important consideration in assessing portfolio risks - will become more frequent. In that case, we ask whether they are still mere tail risks? A few examples in just the last quarter include:

- The Netherlands High Court ruled in May that the oil major Royal Dutch Shell must reduce its net carbon emissions by 49% by 2030. The ruling was the first time a court has explicitly ordered such limits, and there are some worrying implications for investors. The most direct consequence is that the decision makes it more risky for portfolios to hold companies that pollute or facilitate pollution, and as the risk premium goes up for 'dirty' companies, their valuations will decline.
- We should also reflect on the risks to the political landscape given events in the past quarter. Last month swaths of Europe were affected by serious flooding, including the Rhine River in the Netherlands and Germany. The Netherlands' defences held (just), which is unsurprising as the country leads the world when it comes to flood management. In contrast, Germany was caught woefully unprepared to deal with high waters that are increasing in frequency and severity. Nearly 200 people died in Germany and the damage totalled billions of euros. The catastrophe has brought about a sense of urgency for European voters regarding climate change and could lead to significant gains for Germany's Green Party in September's national elections. Europe was already further along the path in its sensitivity to environmental considerations, and we expect recent developments to accelerate the pace.

In conclusion, the rotation back into fast-growing companies with dependable earnings has begun against what is still a benign macroeconomic backdrop. The runway for growth seems clear from our vantage point: the Eurozone will soon start implementing its 750 billion-euro COVID recovery fund and European economies are only starting to open up after COVID vaccinations, likely leading to earnings growth in the short to medium term. We also expect another driver of shareholder returns to come in the form of dividend increases and buybacks that are at least in line with earnings growth. However, the rate of macroeconomic improvement is slowing as forward indicators are peaking or have peaked.

Regional Outlook – Asia

Chris Lai
Associate Portfolio Manager, Asian Equities
RBC Global Asset Management(Asia) Limited

Asian equities fell slightly over the past three months, largely because of a sell-off in Chinese technology stocks beginning in July, as the government increased its oversight in this area. The regulatory threat confronting Chinese growth stocks is unlikely to dissipate in the near term, leading to a rotation into India. In the most recent three-month period, equity markets in India, the Philippines and Australia outperformed, while China and Hong Kong lagged the benchmark.

We expect Asian economies to expand gradually in the months ahead, with growth gaining momentum amid rising demand for exports and increased domestic consumption. Asian central banks will vary in how quickly they tighten monetary policy given differences in the pace of vaccine rollouts, economic recoveries and inflation. Taiwan is benefiting from rising semiconductor prices caused by a global shortage and consumption that has been bolstered by a generally effective response to the pandemic. Elevated COVID-19 cases in the Philippines and Thailand have resulted in tighter restrictions on personal mobility, and could weigh on near-term domestic demand.

Japan

In Japan, we expect economic growth to accelerate due to progress on vaccinations, but a surge in COVID-19 cases emerging from the Summer Olympics in Tokyo suggests economic activity will be flat in the short run. Our view is that the pandemic will tend to push down inflation, although higher commodity prices will be among the factors that lead central banks to nudge interest rates higher. Prime Minister Yoshihide Suga said in early September that he would step aside after less than a year on the job. There is no obvious successor, but it is unlikely that the next leader will make significant changes to economic policy. The main risk to Japan's economy is renewed yen appreciation caused by deepening U.S.-China tensions and concern about the sustainability of financial-market strength.

The Japanese government expects to have 70% of its population fully vaccinated by mid-October, leading to accelerated household consumption by the fourth quarter of this year. That said, recent data do not yet suggest a rebound in consumption. Manufacturing, which had been robust this year, is starting to weaken due in part to the chip shortage.

Japanese inflation remains low but we have seen a gradual uptick due to higher energy prices and some recent yen depreciation. We expect the rise in inflation to be gradual. The Bank of Japan will continue to focus on keeping financial conditions stable through bond purchases and support for lending. Employment has been holding up well. The unemployment rate is forecast to fall to 2.7% in the third quarter of 2021 from 2.8% in the second quarter.

Asia – Recommended sector weights

Sector	MSCI Pacific	Recommended weight
Energy	2.1%	-0.3%
Materials	6.4%	-1.6%
Industrials	11.3%	-0.1%
Consumer discretionary	16.3%	1.2%
Consumer staples	5.6%	-1.4%
Health care	7.6%	0.9%
Financials	16.8%	-0.1%
Information technology	19.1%	1.4%
Communication services	8.9%	1.1%
Utilities	2.0%	-1.0%
Real estate	4.0%	0.0%

-2.0% -1.5% -1.0% -0.5% 0.0% 0.5% 1.0% 1.5% 2.0%

Underweight | Overweight

Note: As of Aug. 2021. Source: RBC GAM

Rest of Asia

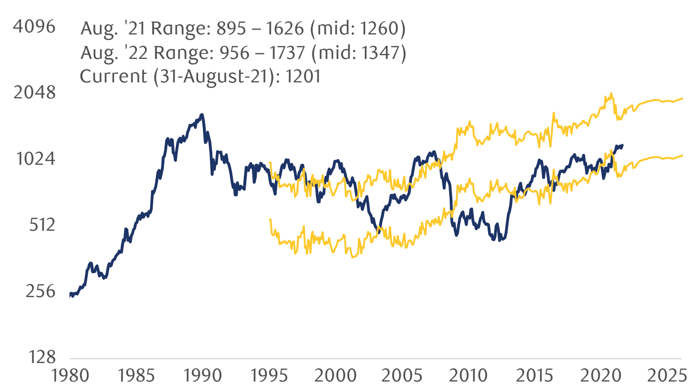
Asia's recovery from the pandemic has been uneven. We expect developed markets in Asia, as well as India, Taiwan and South Korea to outperform, while some other emerging markets in the region remain fragile.

In China, companies that face the higher risk of regulation include those in e-commerce, video gaming, internet services and health care. Stricter state control has led many foreign investors to withdraw investments from Chinese internet stocks and other areas of growth. As a result, valuations of internet-related stocks have come down significantly and may at some point offer potential buying opportunities.

The Chinese economy is likely to now be slowing down, as the rapid spread of the coronavirus's delta variant since late July forced China to impose tighter restrictions and dealt a blow to domestic growth in services. The latest wave of COVID-19 cases takes place at an unfortunate time, as China was recently hit by floods and a typhoon just as the government attempts to damp growth in property and high-polluting industries.

MSCI Japan Index Equilibrium

Normalized earnings and valuations



Source: RBC GAM

In India, economic growth is recovering from a summer COVID-19 wave that was among the world's worst. Elevated inflation suggests the Reserve Bank of India's ultra-accommodative monetary policy has become increasingly unsustainable. The economy has recovered to a level that is now outpacing last year's upswing, with a sharp improvement in mobility and demand for power. Trade in merchandise, services and fuel are up, although readings for manufacturing and purchasing managers' indexes have been softer. Strong global growth, an increased pace of vaccinations and easy financial conditions have economists forecasting year-over-year GDP growth of 9.8% in 2021 and 7.7% in 2022.

Given easy financial conditions, inflationary pressures in India remain uncomfortably high, with expectations for headline inflation averaging 5.4% in 2021 and 5.5% in 2022. These figures are toward the upper range of the central bank's 2%-6% inflation target range. We expect a move to tighten monetary policy in the fourth quarter of this year.

Australia's economy has been solid, boosted by accommodative fiscal and monetary policies, sustained domestic spending and stronger commodity prices. We expect this growth momentum to slow as Australia's relatively slow vaccine roll-out leads to the re-imposition of lockdowns. We remain wary of geopolitical tensions between Australia and China, and the likelihood of weaker Chinese growth by year-end.

The outlook remains subpar in the Philippines, where the pandemic is unlikely to be brought under control until vaccines begin to roll out in large numbers in the first quarter of 2022. At 18%, the Philippines had the lowest percentage of fully vaccinated people in Asia at the end of August. GDP growth in 2021 is forecast at 5.4%, which is below the long-term rate of 6% to 7% prior to the pandemic. The current-account deficit is likely to widen due to worsening terms of trade from imported coal and oil, as well as infrastructure spending in the second half of 2021 ahead of next year's elections. Unemployment is also an issue: the third-quarter forecast for the unemployment rate is 8.4%, compared with a pre-COVID reading of 5.3% in the first quarter of 2020.

Regional Outlook – Emerging markets

Philippe Langham
Head and Senior Portfolio Manager,
Emerging Market Equities
RBC Global Asset Management (UK) Limited

Emerging-market equities have ceded all of this year's outperformance relative to developed-market equities following a sharp decline in Chinese stocks in the MSCI Emerging Markets Index, a rally in the U.S. dollar and a worsening COVID-19 situation in many key emerging markets.

China's drop has been driven primarily by regulatory uncertainty involving technology stocks and aggressive policy tightening. A breakdown of the MSCI China Index reveals that valuations for the most expensive quintile of stocks, which are largely technology-related, have undergone unprecedented declines relative to history and also relative to other segments of the market. While recent regulatory intervention has led to lower valuations for the most expensive segments of the stock market, we find that valuations in these areas are still above historical averages. The valuation premium that the most expensive stocks had built up in recent months could not be explained by an improvement in relative profitability. In fact, returns on equity for the most expensive decile of stocks in China have actually declined significantly in recent years, in both absolute and relative terms.

Beginning in November 2020, investors shifted the focus of their portfolios to value stocks from growth stocks on expectations for a faster economic recovery after successful trials for COVID-19 vaccines. Over this period, the difference in price-to-book valuations among companies with the highest and lowest returns on equity fell to the least since 2009. This move came from investors rewarding lower-quality cyclical companies with higher valuations, and high-growth, low-profitability companies continuing to perform well. This evolution suggests to us that "quality" as a style is out of favour and now appears to be trading at attractive valuation levels compared with growth and value. Returns on equity for higher-quality companies are now seven times those for lower-quality companies, the biggest gap since the global financial crisis in 2008-2009.

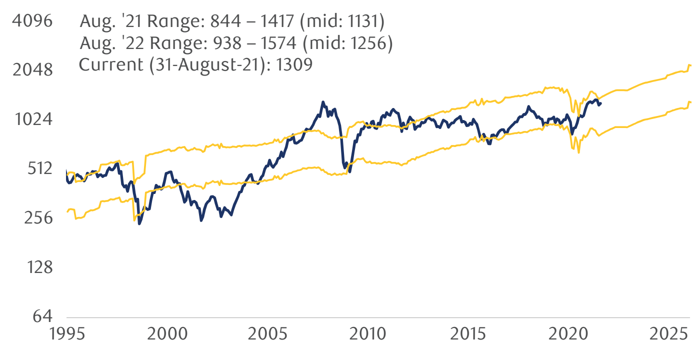
Over the past 12 months, the disparity in performance among emerging-market countries has been widening. Focusing on the past three months, two factors have been significant in determining country-level performance. The first is an increase in political risk in many Latin American countries, where the prospect of electoral shifts toward the hard-left and hard-right have weighed heavily on financial-market performance. Second, emerging markets have lagged developed markets in easing mobility restrictions and reopening their economies. Lately, however, the COVID-19 situation has been improving in key emerging markets such as Brazil and India, and turnarounds have corresponded to stronger financial-market market performance in recent months.

Emerging markets are lagging developed markets in terms of the pace of vaccinations, with a resulting delay in the reopening of their economies. The median level of full vaccination among emerging markets is currently 12%, compared with about 50% in the U.S. and the U.K. In our view, emerging markets will be able to fully recover once their vaccination rates start to catch up with those in developed markets.

Like developed markets, emerging markets have tried to contain the virus with lockdowns and social distancing. The difference has been that developed markets have spent much more liberally to stave off the worst effects of the pandemic and have added significantly more debt than emerging-market governments. In our view, the more limited emerging-market policy response means that emerging-market central banks may have an easier time navigating their way out of the pandemic. In fact, most emerging-market central banks are expected to hike policy rates in the next 12 months, whereas in developed markets the first increases are expected no earlier than 2023. In addition to a healthier debt outlook, many emerging markets have shown significant improvement in their current accounts and fiscal balances, and now appear to be in a stronger positon than the U.S. We believe that these factors, combined with the increasing pace of vaccinations, will enable emerging-market economies to expand faster than developed markets.

Over the last 12 months we have also seen a large dispersion of performance at the sector level. More recently, there has been reversal in the performance of sectors that benefited from the COVID-19 pandemic such as Health Care, Consumer Discretionary, Communication Services (notably social media) and Information Technology. As a result, stark valuation differences exist throughout emerging markets at the sector level, the most notable being between Information Technology and Financials. Emerging-market technology stocks now trade at a 220% premium to financial stocks. This valuation difference has narrowed in recent weeks but remains significantly higher than historical levels.

MSCI Emerging Markets Index Equilibrium
Normalized earnings and valuations



Source: RBC GAM

Among cyclical sectors, we have a preference for Financials. Emerging-market financial companies, particularly banks, have undergone an extended cyclical slowdown for most of the current decade, exacerbated by the pandemic. We are, however, positive on the sector longer term and believe that these companies are well positioned to benefit as the number of businesses and individuals making use of loans, insurance and other financial services continues to expand. In recent years, we have broadened our exposure from banks to include insurance, where there is also a low level of market penetration compared with developed markets.

In the near term, we believe that emerging-market banks are likely to be supported by reopening economies, a resumption in loan growth and improving asset quality. Moreover, expectations that interest rates will rise are likely to bolster banks' profit margins. Over the years we have consolidated our holdings in emerging-market banks to focus on the highest-quality companies, which face fewer competitive threats from new financial technology and demonstrate sustainability of returns. We believe that banks with strong deposit bases will maintain a significant competitive advantage and therefore higher and more sustainable returns over time.

RBC GAM Investment Strategy Committee Members

Daniel E. Chornous, CFA

Chief Investment Officer
RBC Global Asset Management Inc.

Chair, RBC GAM Investment Strategy Committee

Dan Chornous is Chief Investment Officer of RBC Global Asset Management Inc., which has total assets under management of approximately $601.3 billion*. Mr. Chornous is responsible for the overall direction of investment policy and fund management. In addition, he chairs the RBC Investment Strategy Committee, the group responsible for global asset-mix recommendations and global-fixed income and equity portfolio construction for use in RBC Wealth Management's key client groups including retail mutual funds, International Wealth Management, RBC Dominion Securities Inc. and RBC Phillips, Hager & North Investment Counsel Inc. He also serves on the Board of Directors of the Canadian Coalition for Good Governance and is Chair of its Public Policy Committee. Prior to joining RBC Asset Management in November 2002, Mr. Chornous was Managing Director, Capital Markets Research and Chief Investment Strategist at RBC Capital Markets. In that role, he was responsible for developing the firm's outlook for global and domestic economies and capital markets as well as managing the firm's global economics, technical and quantitative research teams.

*AUM in CAD as of August 31, 2021

Stephen Burke, PhD, CFA

Vice President and Portfolio Manager
RBC Global Asset Management Inc.

Stephen is a fixed-income portfolio manager and Head of the Quantitative Research Group, the internal team that develops quantitative research solutions for investment decision-making throughout the firm. He is also a member of the PH&N IM Asset Mix Committee. Stephen joined Phillips, Hager & North Investment Management in 2002. The first six years of his career were spent at an investment-counselling firm where he quickly rose to become a partner and fixed-income portfolio manager. He then took two years away from the industry to begin his Ph.D. in Finance and completed it over another three years while serving as a fixed-income portfolio manager for a mutual-fund company. Stephen became a CFA charterholder in 1994.

Soo Boo Cheah, MBA, CFA

Senior Portfolio Manager
RBC Global Asset Management (UK) Limited

Based in the U.K., Soo Boo is responsible for managing global fixed-income allocations. He specializes in assessing the impact of central bank policies and global macroeconomic trends on developed-market bonds. In his role as a senior portfolio manager, he integrates a wide range of investment strategies involving interest rates, currencies, and derivatives. Soo Boo started his career in the investment industry in 2000 and holds an MBA from University of New Brunswick. Soo Boo has been a CFA charterholder since 2002.

Hanif Mamdani

Head of Alternative Investments
RBC Global Asset Management Inc.

Hanif Mamdani is Head of both Corporate Bond Investments and Alternative Investments. He is responsible for the portfolio strategy and trading execution of all investment-grade and high-yield corporate bonds. Hanif is Lead Manager of the PH&N High Yield Bond and Alternative strategies, including a multi-strategy hedge fund. He is also a member of the Asset Mix Committee. Prior to joining the firm in 1998, he spent 10 years in New York with two global investment banks working in a variety of roles in Corporate Finance, Capital Markets and Proprietary Trading. Hanif holds a master's degree from Harvard University and a bachelor's degree from the California Institute of Technology.

Sarah Riopelle, CFA

Vice President and Senior Portfolio Manager
Investment Solutions
RBC Global Asset Management Inc.

Since 2009, Sarah has managed the entire suite of RBC Portfolio Solutions. Sarah is a member of the RBC GAM Investment Strategy Committee, which sets global strategy for the firm, and the RBC GAM Investment Policy Committee, which is responsible for the investment strategy and tactical asset allocation for RBC Funds' balanced products and portfolio solutions. In addition to her fund management role, she works closely with the firm's Chief Investment Officer, ensuring that all aspects of the investment management function at RBC GAM are running smoothly. She is a member of the RBC Wealth Management Diversity Leadership Committee. Sarah joined RBC Global Asset Management in 2003 as a Senior Analyst within Investment Strategy. From there, she moved to the Canadian Equity team as an analyst and then a portfolio manager. She began her career in the investment industry in 1996 after graduating from the University of Ottawa with a Bachelor of Commerce degree, majoring in Finance and International Management. She was awarded the Chartered Financial Analyst designation in 2001.

Martin Paleczny, CFA

Vice President and
Senior Portfolio Manager
RBC Global Asset Management Inc.

Martin Paleczny, who has been in the investment industry since 1994, began his career at Royal Bank Investment Management, where he developed an expertise in derivatives management and created a policy and process for the products. He also specializes in technical analysis and uses this background to implement derivatives and hedging strategies for equity, fixed-income, currency and commodity-related funds. Since becoming a portfolio manager, Martin has focused on global allocation strategies for the full range of assets, with an emphasis on using futures, forwards and options. He serves as advisor for technical analysis to the RBC GAM Investment Strategy Committee.

Jaco Van der Walt, DCom

Vice President and
Global Head of Quantitative Research & Investments
RBC Global Asset Management Inc.

As Head of Quantitative Investments, Jaco leads an experienced team that is driven to continually innovate across all its capabilities, including research, portfolio management, data and systems to leverage the combination of human and machine in investment decision-making. He previously held an executive role at one of South Africa's largest financial services companies, leading the Investment Management Office, with experience spanning pensions, insurance, banking and wealth management. As asset owner, he also chaired the boards and investment committees of several of the company's pension plans, promoting investment excellence and driving transformational change to ensure members reach their retirement goals. Jaco began his investment career in 1996 and holds a Master's degree in Economics from the University of Toronto and a Doctorate from the University of Pretoria.

Dagmara Fijalkowski, MBA, CFA

Head, Global Fixed Income & Currencies
RBC Global Asset Management Inc.

As Head of Global Fixed Income and Currencies, Dagmara leads a team of 40+ investment professionals in Toronto, London and Minneapolis with almost $100 billion in assets under management. In her duties as a portfolio manager, Dagmara leads management of several bond funds, including the RBC Bond Fund, and manages foreign-exchange hedging and active overlay programs. She leads the Fixed Income Strategy Committee which determines appropriate level of risk taking given market opportunities. Dagmara is a member of the RBC Investment Policy Committee, which determines the asset mix for balanced products; and the RBC Investment Strategy Committee. In 2016, she was appointed to the RBC GAM Executive Committee. Dagmara, who began her investment career in 1994, holds an MBA from the Richard Ivey School of Business at the Western University in Canada and a Master's degree in economics from the University of Lodz in Poland. Dagmara has been a CFA charterholder since 1997.

Stuart Kedwell, CFA

Senior Vice President and
Senior Portfolio Manager
RBC Global Asset Management Inc.

Stu co-leads the North American Equity team and is a member of the RBC GAM Investment Strategy Committee, which is responsible for establishing the firm-wide global asset mix for mutual funds and for institutional and high net worth private clients. Stu began his career in 1996 with RBC Dominion Securities in the firm's Generalist program, a two-year internship in which participants rotate through different areas of the firm. In 1998, he joined the RBC Investments Portfolio Advisory Group, which provides investment ideas and recommendations to RBC DS Investment Advisors. He was also a member of the RBC DS strategy & focus list committees. Stu has been with the firm since 2002 and is a CFA charterholder.

Eric Lascelles

Chief Economist
RBC Global Asset Management Inc.

Eric is the Chief Economist for RBC Global Asset Management Inc. (RBC GAM) and is responsible for maintaining the firm's global economic forecast and generating macroeconomic research. He is also a member of the RBC GAM Investment Strategy Committee, the group responsible for the firm's global asset-mix recommendations. Eric is a frequent media commentator and makes regular presentations both within and outside RBC GAM. Prior to joining RBC GAM in early 2011, Eric spent six years at a large Canadian securities firm, the last four as the Chief Economics and Rates Strategist. His previous experience includes positions as economist at a large Canadian bank and research economist for a federal government agency.

Scott Lysakowski, CFA

Vice President and Senior Portfolio Manager
Head of Canadian Equities (Vancouver)
RBC Global Asset Management Inc.

Scott is Head of the Vancouver-based Canadian Equity Team. He is primarily responsible for overseeing equity research and portfolio management of the firm's core Canadian equity strategies. Scott also serves as lead manager for the Canadian income strategies. Scott began his investment management career with the firm in 2002 as a senior research analyst and portfolio manager within the Toronto-based Canadian Equity Team. He transitioned to the Vancouver team seven years later and assumed his current leadership role in 2012. During his 15-year tenure with the organization, he has conducted research for and managed a broad spectrum of Canadian equity portfolios, specializing in dividend and income mandates.

Milos Vukovic, CFA

Vice President, Investment Policy
RBC Global Asset Management Inc.

Milos, who joined RBC in 2003, oversees investment-management activities including new-fund launches, performance analytics and trade-cost analysis. He is also responsible for developing and monitoring investment mandates and implementing tactical asset allocation for the RBC GAM investment solutions. Milos earlier worked for a Big 4 accounting firm and two top-tier securities firms. He earned an MBA at the Schulich School of Business and has held the CFA designation since 2004. He is a board member of both the Canadian Buy-Side Investment Management Association and the Canadian Advocacy Council for Canadian CFA Institute Societies, and recently joined IIROC's Market Structure Advisory Committee.

Brad Willock, CFA

Vice President and
Senior Portfolio Manager
RBC Global Asset Management Inc.

Brad Willock joined RBC Global Asset Management in July 2002 and is a Senior Portfolio Manager and CFA charterholder. In his current role, Brad has responsibility for RBC Global Asset Management's core and income-oriented U.S. equity strategies. He joined RBC in May 1996 after receiving a bachelor's of commerce degree with distinction from the University of Calgary. Prior to that, Brad obtained a bachelor's of science degree at the University of British Columbia and represented Canada at the 1992 Barcelona Summer Olympics in volleyball.

Global equity advisory committee

> **Philippe Langham**
> Head & Senior Portfolio Manager, Emerging Market Equities
> RBC Global Asset Management (UK) Limited

> **Brad Willock, CFA**
> V.P. & Senior Portfolio Manager, North American Equities
> RBC Global Asset Management Inc.

> **Mayur Nallamala**
> Head & Senior V.P., Asian Equities
> RBC Global Asset Management (Asia) Limited

> **Martin Paleczny, CFA**
> V.P. & Senior Portfolio Manager, Asset Allocation & Derivatives
> RBC Global Asset Management Inc.

> **Dominic Wallington**
> Head, European Equities & Senior Portfolio Manager,
> RBC Global Asset Management (UK) Limited

Global Fixed Income & Currencies advisory committee

> **Dagmara Fijalkowski, MBA, CFA**
> Head, Global Fixed Income & Currencies
> RBC Global Asset Management Inc.

> **Soo Boo Cheah, MBA, CFA**
> Senior Portfolio Manager, Global Fixed Income & Currencies
> RBC Global Asset Management (UK) Limited

> **Suzanne Gaynor**
> V.P. & Senior Portfolio Manager, Global Fixed Income & Currencies
> RBC Global Asset Management Inc.

> **Eric Lascelles**
> Chief Economist
> RBC Global Asset Management Inc.

Disclosure

This document is provided by RBC Global Asset Management (RBC GAM) for informational purposes only and may not be reproduced, distributed or published without the written consent of RBC GAM or its affiliated entities listed herein. This document does not constitute an offer or a solicitation to buy or to sell any security, product or service in any jurisdiction; nor is it intended to provide investment, financial, legal, accounting, tax, or other advice and such information should not be relied or acted upon for providing such advice. This document is not available for distribution to investors in jurisdictions where such distribution would be prohibited.

RBC GAM is the asset management division of Royal Bank of Canada (RBC) which includes RBC Global Asset Management Inc., RBC Global Asset Management (U.S.) Inc., RBC Global Asset Management (UK) Limited, RBC Global Asset Management (Asia) Limited, and BlueBay Asset Management LLP, which are separate, but affiliated subsidiaries of RBC.

In Canada, this document is provided by RBC Global Asset Management Inc. (including PH&N Institutional) which is regulated by each provincial and territorial securities commission with which it is registered. In the United States, this document is provided by RBC Global Asset Management (U.S.) Inc., a federally registered investment adviser. In Europe this document is provided by RBC Global Asset Management (UK) Limited, which is authorised and regulated by the UK Financial Conduct Authority. In Asia, this document is provided by RBC Global Asset Management (Asia) Limited, which is registered with the Securities and Futures Commission (SFC) in Hong Kong.

Additional information about RBC GAM may be found at www.rbcgam.com.

This document has not been reviewed by, and is not registered with any securities or other regulatory authority, and may, where appropriate and permissible, be distributed by the above-listed entities in their respective jurisdictions.

Any investment and economic outlook information contained in this document has been compiled by RBC GAM from various sources. Information obtained from third parties is believed to be reliable, but no representation or warranty, express or implied, is made by RBC GAM, its affiliates or any other person as to its accuracy, completeness or correctness. RBC GAM and its affiliates assume no responsibility for any errors or omissions.

Opinions contained herein reflect the judgment and thought leadership of RBC GAM and are subject to change at any time. Such opinions are for informational purposes only and are not intended to be investment or financial advice and should not be relied or acted upon for providing such advice. RBC GAM does not undertake any obligation or responsibility to update such opinions.

RBC GAM reserves the right at any time and without notice to change, amend or cease publication of this information.

Past performance is not indicative of future results. With all investments there is a risk of loss of all or a portion of the amount invested. Where return estimates are shown, these are provided for illustrative purposes only and should not be construed as a prediction of returns; actual returns may be higher or lower than those shown and may vary substantially, especially over shorter time periods. It is not possible to invest directly in an index.

Some of the statements contained in this document may be considered forward-looking statements which provide current expectations or forecasts of future results or events. Forward-looking statements are not guarantees of future performance or events and involve risks and uncertainties. Do not place undue reliance on these statements because actual results or events may differ materially from those described in such forward-looking statements as a result of various factors. Before making any investment decisions, we encourage you to consider all relevant factors carefully.

RBC Global Asset Management

® / ™ Trademark(s) of Royal Bank of Canada. Used under licence.
© RBC Global Asset Management Inc. 2021

Publication date: September 15, 2021

100537 (09/2021)

GIO_FALL_2021_EN 09/15/2021