RBC Global Asset Management

Asset class commentary

SPRING 2025

Global economy

This is a time of elevated uncertainty, stemming primarily from U.S. government policy. Until recently, one could argue that the net effect of the new policies would be to accelerate U.S. economic growth, raise inflation and slightly diminish rest-of-world economic growth. However, recent developments point in a less favourable direction. Tariffs are being applied with an unanticipated vigour, and recent animal spirits – the enthusiasm initially shown by households and businesses to the Trump administration – are now fading. In turn, the U.S. growth outlook has been downgraded along with the growth outlooks for nations like Canada and Mexico, which are most adversely affected.

Perhaps the White House will take heed of recent financial market concerns and steer policy in a more growth-supportive direction. But this is far from certain.

Setting public policy aside, U.S. economic growth is decelerating slightly, whereas the Eurozone, UK, Japan and China are seemingly on an accelerating track.

Fixed Income

Bond yields are still near their post-pandemic highs and inflation is much lower. We expect bonds to deliver at least coupon-like returns somewhere in the low-to-mid single digits over the year ahead. Lower inflation is also a boon for those expecting bonds to act as a counterbalance to the risk of an equity sell off as the negative correlation between stock and bond returns has historically asserted itself when inflation is at or below current levels.

All that said, we expect returns among bond markets to show a greater divergence over the year ahead than has been the case in recent years. Investors may be too optimistic about the U.S economy and too pessimistic about the outlooks for Canada and Europe. We expect U.S. Treasuries to outperform as the economy is likely to struggle to meet lofty expectations, regardless of the impact of new policies under the Trump administration.

Canada

The S&P TSX Composite Index recorded total returns of -0.3% in the three months ended February 28, 2025. Uncertainty has emerged in recent months about the path of earnings growth and interest rates as the new U.S. administration has threatened to ramp up global trade barriers. Moreover, the political outlook will remain murky until the federal election takes place. There are signs that uncertainty is weighing on consumer and business confidence and investment. Investors are focused on what the many changes being discussed will mean for corporate profits and valuations. As a result, the stock market is in a wait-and-see pattern, with investors exercising caution.

Canada's economy is expected to expand 1.6% in 2025, compared with 1.3% in 2024. Current consensus estimates are for S&P/TSX earnings to rise 10% in 2025, and another 10% in 2026. However, these forecasts have not yet accounted for the negative impact of proposed tariffs.

United States

U.S. stocks, measured by the S&P 500 Index, dropped 1% during the three months ended February 28, 2025. Economic growth has been above trend, unemployment low and corporate earnings better than expected. Initially, investors were quick to price in the potential upside from tax cuts and deregulation and overlooked the potential headwinds from tariffs. But expectations have shifted as the administration announced intentions to impose tariffs on its closest trading partners.

Consensus is for 10% profit growth for the S&P 500 in 2025. This bar is high but achievable without serious policy error. However, the S&P 500 trades at roughly 21 times the next 12 months' estimated earnings, which is expensive relative to history. High valuations reflect elevated investor optimism about the future for artificial intelligence (AI)-related mega-cap stocks. To keep the bull market going, we need earnings to continue to surprise on the upside.

Europe

European equity markets underperformed the global benchmark last year, and the current macroeconomic climate is fraught with challenges such as sluggish economic growth, high inflation and political uncertainty. Nonetheless, there's a glimmer of hope as European stocks trade at valuations below their long-term averages. A weaker euro and the additional fiscal spending in Germany are among the factors that could help revive Europe's economy. Other potential positives include the chance that the new U.S. administration's approach to tariffs may be less aggressive than many investors believe given that the approach, as contemplated, could be detrimental to the U.S. economy. Additionally, the prospect of an end to the Russia/Ukraine war and further Chinese economic stimulus could contribute to a more favourable investment climate. The start of the year has shown some promise, with the MSCI Europe Index outperforming the MSCI World Index by nine percentage points as of February 28, 2025.

Asia Pacific

Asian equities posted moderate gains over the past three months, slightly outperforming global equity markets. China and Hong Kong outperformed on awareness of the AI tool DeepSeek, which rekindled expectations for China's potential to boost innovation. Indonesia and India underperformed.

We expect Asian equity volatility in 2025 as President Trump enacts his trade policies. In Japan, we expect economic growth and corporate reforms to lead to better return on equity. China's outlook likely hinges on two factors: external tariffs and domestic stimulus. In India, GDP growth should improve with expected monetary easing and rural consumption growth. We believe the Australian economy troughed in 2024 and improvement should come from fiscal spending, wage growth and domestic demand. In South Korea, we expect political uncertainty to ease following the ouster of its president who declared martial law and the political fallout of a publicized plane crash.

Emerging markets

The underperformance of emerging market (EM) equities last year and over the past five years was driven by U.S. exceptionalism and China weakness.

Looking ahead to 2025, earnings growth should become a key driver of EM equities returns. The robust EPS growth recorded in 2024 and expected in 2025 represents a significant shift and a major acceleration from the previous 10-year average of 2%. EM valuations have also become particularly attractive. EM Equities now trade at a 35% discount to developed market equities in terms of price-to-earnings ratio, the largest discount in the last 15 years. While valuation does not drive short-term performance it should offer longer-term support.

We see three key structural and cyclical drivers for a change in the EPS growth for EM: China's return-on-equity (ROE) recovery, monetary policy easing and continued strong global investments in technology, given a large part of the value chain is in EM.

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