

RBC Global Asset Management

The Global Investment Outlook

RBC GAM Investment Strategy Committee



SUMMER 2021



The RBC GAM Investment Strategy Committee

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*.



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Executive Summary

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The latest wave of COVID-19 infections is now retreating, allowing governments to incrementally reopen their economies. Strong growth, surging corporate profits and elevated investor confidence have helped to extend the bull market and boost global equities to record highs.

Economy buoyed by positive vaccine efforts

Vaccines have now reached close to half the population in many developed countries and are increasingly gaining traction in other nations. As containment of the virus improves and economies gradually reopen, considerable pent-up consumer and business demand is being unleashed and permanent scarring from the pandemic so far appears to be limited. Our business-cycle framework continues to situate the economy in the “early cycle” stage and suggests further room for gains, although we note that the cycle is moving more quickly than normal. We remain optimistic about the trajectory of the economy and anticipate rapid growth in 2021, followed by slower but still good growth in 2022. That said, a significant rise in market expectations tempers our enthusiasm somewhat as heightened expectations are becoming more difficult to surpass. Our economic forecasts are mostly at or slightly above the consensus, a marginally less bullish positioning than in past quarters.

Risks to our positive outlook

A variety of risks may challenge our positive base case scenario. The extremely contagious Indian variant of the virus could prompt further waves of infection similar to how the emergence of the highly contagious British variant contributed to a surge in the spring. Moreover, there is a risk of a fiscal hangover in 2022 as some spending initiatives expire, and the possibility exists that investor confidence will wane if central banks contemplate withdrawing monetary

stimulus. Another key risk is that inflation has spiked higher. While we believe much of the increase is temporary, a period of sustained higher inflation would erode purchasing power, increase borrowing costs and encourage central banks to be more hawkish.

Inflation accelerates as price pressures mount

Base effects, higher commodity prices and factors such as shortages of shipping containers and computer chips are contributing to rising inflation, which is now accelerating in a number of countries. We expect elevated inflation over the next several months, moving to moderately above the long-term average over the next few years, but ultimately average or even slightly below average inflation over the longer term. Stimulus cheques have prompted many Americans to splurge on big-ticket goods such as cars and houses, pushing prices higher. But demand preferences should revert at least partially to historical norms as the impact of the pandemic fades. There are, however, several scenarios that could lead to an unwelcome period of relatively high inflation. Rising inflation expectations could become a self-fulfilling prophecy, a wage-price spiral could unfold, and/or a commodity supercycle could emerge. Inflation, an afterthought for the past decade, now requires some attention.

U.S. dollar bear market to persist

We think the U.S.-dollar bear market that began last year still has a few years to run. Currencies often move in cycles, from overvalued to

undervalued, and the dollar remains rich even with the weakness of the past year. The stimulative fiscal and monetary policies pursued by the U.S. support the weakening trend. Cyclical periods of strength, like the one seen in the first quarter of this year, are good opportunities, we think, to position portfolios for a further U.S.-dollar decline. While the early stages of a bear market in the greenback will benefit all currencies, it is cyclical currencies, including the Canadian dollar, that have the most to gain from the global economic recovery underway. Broadly speaking, emerging-market currencies should also rally, although careful monitoring of country-specific risks is necessary to avoid individual currency underperformance.

Bond yields pause after massive rise earlier in the year

Much of the good news related to vaccines, a reopening of economies and firming inflation was priced into the bond market in late 2020 and early 2021, and so there was little impetus for yields to rise further in the past quarter. Bond yields everywhere were range-bound over the past three months after having reclaimed their pre-pandemic levels earlier in the year. Our models indicate the acute valuation risk evident in the sovereign-bond market immediately following the pandemic's declaration was greatly alleviated by the rapid rise in yields over the past year. Once the impact of the pandemic fades, we could be left with real (after-inflation) yields in the 0% to 1% range, with a 2% inflation premium for U.S. Treasury bonds. If

these assumptions prove correct, it would be difficult for 10-year U.S. government bond yields to rise much above 2% to 3% over the medium to longer term. In the shorter term, we see yields peaking around 1.75% over the next year and, as a result, expect low returns in sovereign bonds.

Stocks rally to record levels on surging profits

Global equities extended their gains in the past quarter with most major indexes reaching record levels. The solid rally in stocks has pushed our global composite of equity-market valuations to its highest level since before the 2008/2009 financial crisis. We note that the extended valuation in stocks largely reflects the dominance of U.S. markets in our GDP-weighted model. While the S&P 500 Index may currently appear expensive, it could grow into those elevated valuations fairly quickly as a surging economy boosts volumes and pricing power, lifting revenues and earnings, and leading to a durable earnings expansion that could last several years. Analysts are quickly picking up on the fact that profits are rebounding quickly and earnings-per-share estimates for the S&P 500 have increased nearly 10% since the start of the year. Our conclusion is that U.S. stocks could offer decent returns in the mid to high single digits as long as investor confidence holds up and earnings come through. Return potential improves as we move outside of North America to regions such as Europe, Japan and emerging markets, all of which offer more attractive valuations.

Asset Mix – maintaining overweight in stocks, underweight in bonds

The economic recovery is fanned by the cyclical tailwinds of massive monetary and fiscal stimulus, an easing of virus-related restrictions and low interest rates. We expect strong economic growth in 2021 and again next year as the economy accelerates at a rate that supports solid corporate-profit gains. In this environment, we think a significant overweight in equities is appropriate. Recall that ultra-low return expectations in fixed income motivated our decision over a year ago to boost the strategic neutral weight in stocks to 60% from 55%. Investors with long-term savings plans, in our view, would likely want to minimize exposure to low-returning sovereign bonds and boost equity allocations. That said, the powerful advance of U.S. equities over the past year prompts us to recognize that their valuations are full and that the risk premium between stocks and bonds has narrowed somewhat. We have therefore trimmed our overweight equity exposure by 50 basis points from last quarter, sourced entirely from U.S. equities, and moved the proceeds to bonds. For a balanced, global investor, we currently recommend an asset mix of 64 percent equities (strategic neutral position: 60 percent) and 35 percent fixed income (strategic neutral position: 38 percent), with the balance in cash.

Economic & Capital Markets Forecasts

Economic forecast (RBC GAM Investment Strategy Committee)

	United States		Canada		Europe		United Kingdom		Japan		China		Emerging markets*	
	Summer 2021	Change from Spring 2021	Summer 2021	Change from Spring 2021	Summer 2021	Change from Spring 2021	Summer 2021	Change from Spring 2021	Summer 2021	Change from Spring 2021	Summer 2021	Change from Spring 2021	Summer 2021	Change from Spring 2021
Real GDP														
2020A	(3.49%)		(5.40%)		(6.74%)		(9.83%)		(4.74%)		2.01%		(1.40%)	
2021E	6.40%	0.40	6.10%	0.90	4.60%	(0.70)	6.00%	(0.10)	3.10%	(0.90)	9.00%	N/C	8.00%	0.20
2022E	4.10%	0.40	3.70%	(0.20)	4.60%	0.20	6.20%	0.40	3.00%	N/C	5.50%	N/C	5.20%	0.20
CPI														
2020A	1.25%		0.75%		0.25%		0.85%		(0.02%)		2.49%		3.37%	
2021E	3.60%	1.40	2.80%	0.80	2.00%	1.20	1.80%	0.60	0.10%	0.30	1.40%	0.10	2.85%	0.35
2022E	2.70%	0.60	2.40%	0.30	1.70%	0.30	2.20%	0.30	0.80%	N/C	2.50%	0.10	3.15%	0.25

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

Targets (RBC GAM Investment Strategy Committee)

	May 2021	Forecast May 2022	Change from Spring 2021	1-year total return estimate* (%)
Currency Markets against USD				
CAD (USD–CAD)	1.21	1.15	(0.03)	5.2
EUR (EUR–USD)	1.22	1.30	N/C	5.6
JPY (USD–JPY)	109.58	103.00	4.00	6.2
GBP (GBP–USD)	1.42	1.40	0.04	(1.5)
Fixed Income Markets				
U.S. Fed Funds Rate	0.13	0.13	N/C	N/A
U.S. 10-Year Bond	1.59	1.75	0.45	0.2
Canada Overnight Rate	0.25	0.25	N/C	N/A
Canada 10-Year Bond	1.49	1.50	0.40	1.4
Eurozone Deposit Facility Rate	(0.50)	(0.50)	N/C	N/A
Germany 10-Year Bund	(0.19)	(0.25)	0.10	0.5
U.K. Base Rate	0.10	0.10	N/C	N/A
U.K. 10-Year Gilt	0.80	0.70	0.20	1.7
Japan Overnight Call Rate	(0.03)	(0.10)	N/C	N/A
Japan 10-Year Bond	0.09	0.10	0.05	(0.0)
Equity Markets				
S&P 500	4204	4350	425	4.9
S&P/TSX Composite	19731	20200	1700	5.0
MSCI Europe	148	158	15	9.9
FTSE 100	7023	7375	475	8.8
Nikkei	28860	30700	(1300)	8.1
MSCI Emerging Markets	1376	1490	65	10.7

*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 returns¹ and the volatility² 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 setting is 60% equities, 38% fixed income, 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	Summer 2020	Fall 2020	New Year 2021	Spring 2021	Summer 2021
Cash	2.0%	0.0% – 17.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Bonds	38.0%	23.0% – 53.0%	38.0%	37.0%	34.5%	34.5%	35.0%
Stocks	60.0%	35.0% – 75.0%	61.0%	62.0%	64.5%	64.5%	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							
	WGBI* May 2021	Allowable range	Summer 2020	Fall 2020	New Year 2021	Spring 2021	Summer 2021
Global Bonds							
North America	41.7%	30.8% – 50.8%	42.3%	41.3%	41.1%	40.8%	41.7%
Europe	41.2%	31.9% – 51.9%	39.0%	36.0%	41.0%	36.9%	46.2%
Asia	17.1%	7.3% – 27.3%	18.7%	22.7%	17.8%	22.3%	12.1%

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

	MSCI** May 2021	Allowable range	Summer 2020	Fall 2020	New Year 2021	Spring 2021	Summer 2021
Global Equities							
North America	67.4%	56.8% – 76.8%	65.7%	65.4%	66.0%	65.3%	65.7%
Europe	15.6%	5.6% – 25.6%	16.1%	16.2%	14.6%	15.4%	16.2%
Asia	8.7%	0.0% – 19.3%	10.7%	9.8%	10.6%	10.4%	9.4%
Emerging Markets	8.3%	0.0% – 18.3%	7.5%	8.6%	8.8%	8.9%	8.8%

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** May 2021	RBC GAM ISC Spring 2021	RBC GAM ISC Summer 2021	Change from Spring 2021	Weight vs. Benchmark	
Energy	3.04%	2.37%	2.04%	(0.33)	67.1%	
Materials	4.57%	5.95%	6.07%	0.11	132.9%	
Industrials	10.65%	9.80%	10.65%	0.85	100.0%	
Consumer Discretionary	12.13%	14.42%	14.13%	(0.28)	116.5%	
Consumer Staples	7.05%	5.17%	5.55%	0.39	78.7%	
Health Care	12.30%	12.79%	11.20%	(1.60)	91.1%	
Financials	13.80%	12.88%	14.80%	1.92	107.2%	
Information Technology	21.54%	24.34%	23.34%	(1.00)	108.4%	
Communication Services	9.25%	9.11%	9.25%	0.13	100.0%	
Utilities	2.95%	1.05%	0.95%	(0.11)	32.1%	
Real Estate	2.73%	2.12%	2.03%	(0.09)	74.4%	

*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 recommendation	Current recommendation
Cash & Cash Equivalents	2%	0-15%	1.0%	1.0%
Fixed Income	73%	68-88%	69.9%	70.2%
Total Cash & Fixed Income	75%	60-90%	70.9%	71.2%
Canadian Equities	10%	0-20%	11.4%	11.4%
U.S. Equities	8%	0-18%	9.2%	8.9%
International Equities	7%	0-17%	8.5%	8.5%
Emerging Markets	0%	0%	0.0%	0.0%
Total Equities	25%	10-40%	29.1%	28.8%
			Return	Volatility
40-year average			8.6%	5.3%
Last 12 months			4.9%	4.5%

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	Benchmark	Range	Last quarter recommendation	Current recommendation
Cash & Cash Equivalents	2%	0-15%	1.0%	1.0%
Fixed Income	58%	43-83%	54.6%	55.1%
Total Cash & Fixed Income	60%	45-75%	55.6%	56.1%
Canadian Equities	13%	3-23%	14.1%	14.1%
U.S. Equities	15%	5-25%	16.5%	16.0%
International Equities	12%	2-22%	13.8%	13.8%
Emerging Markets	0%	0%	0.0%	0.0%
Total Equities	40%	25-55%	44.4%	43.9%
			Return	Volatility
40-year average			9.0%	6.4%
Last 12 months			8.8%	5.4%

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	Benchmark	Range	Last quarter recommendation	Current recommendation
Cash & Cash Equivalents	2%	0-15%	1.0%	1.0%
Fixed Income	38%	23-53%	34.5%	35.0%
Total Cash & Fixed Income	40%	25-55%	35.5%	36.0%
Canadian Equities	15%	5-25%	15.5%	15.6%
U.S. Equities	25%	15-35%	26.5%	25.9%
International Equities	15%	5-25%	16.7%	16.8%
Emerging Markets	5%	0-15%	5.8%	5.7%
Total Equities	60%	45-75%	64.5%	64.0%
			Return	Volatility
40-year average			9.2%	7.7%
Last 12 months			14.4%	6.7%

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 recommendation	Current recommendation
Cash & Cash Equivalents	2%	0-15%	1.0%	1.0%
Fixed Income	23%	8-38%	19.4%	19.9%
Total Cash & Fixed Income	25%	10-40%	20.4%	20.9%
Canadian Equities	18%	8-28%	18.2%	18.5%
U.S. Equities	30%	20-40%	31.5%	30.8%
International Equities	19%	9-29%	20.9%	21.0%
Emerging Markets	8%	0-18%	9.0%	8.8%
Total Equities	75%	60-90%	79.6%	79.1%
			Return	Volatility
40-year average			9.3%	9.5%
Last 12 months			18.8%	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 recommendation	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%	28.5%	28.9%
U.S. Equities	38%	28-48%	38.0%	37.4%
International Equities	20%	10-30%	21.2%	21.5%
Emerging Markets	11%	1-21%	11.8%	11.7%
Total Equities	98%	83-100%	99.5%	99.5%
			Return	Volatility
40-year average			9.2%	12.1%
Last 12 months			26.3%	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

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V.P. & Head of Investment Policy
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Aaron Ma, CFA

Senior Analyst, Investment Strategy
RBC Global Asset Management Inc.

The U.S. dollar declined against many major currencies in the quarter ended May 31, 2021. The worsening U.S. current-account and budget deficits, the global economic recovery and the U.S. Federal Reserve's commitment to maintaining an accommodative monetary-policy stance all put pressure on the U.S. dollar during the period. The greenback weakened against the Canadian dollar, euro and British pound by 5.2%, 1.9% and 1.3%, respectively, but rose 2.7% versus the Japanese yen. The loonie was especially strong as it benefited from improving domestic and global economic conditions, rising commodity prices and a central bank that appeared poised to raise interest rates before its peers. Similar optimism about economic growth from the lifting of COVID-19 restrictions in the U.K. and Europe boosted their currencies. By the same token, the yen was dragged down by rising COVID-19 case counts and accompanying restrictions that have put the summer Olympic Games at risk of being cancelled. The Canadian dollar, euro and British pound also appreciated significantly versus the U.S. dollar over the one-year period, with gains between 9.2% for the single currency and 13.1% for sterling.

Global fixed-income returns were flat this past quarter as yields were range-bound with muted moves in many key markets. The 10-year Treasury-bond yield rose just 19 basis points to 1.59%, compared with a 57-basis-point increase the prior quarter, as inflation expectations remained in check and employment gains were not as strong as previously expected. Excluding the FTSE Canada Universe Bond Index's 4.6% gain in U.S. dollars due to the rising loonie, returns ranged from -1.5% for the FTSE Japanese Government Bond Index and 0.24% for the FTSE European Government Bond Index. Over the one-year period, returns were likewise impacted by currency moves, with gains of 12.1% for the FTSE Canada Universe Bond Index and 9.7% for the FTSE European Government Bond Index, while the FTSE Japanese Government Bond Index declined 2.2%.

The rally in global equities continued apace, with many major indexes setting all-time highs in the past quarter. Global stocks were driven higher as investors were focused on the vigour of the economic recovery and better prospects for corporate earnings. All the main markets we follow were in the green and the S&P/TSX Composite Index took the top spot with a 16.0% return in U.S.-dollar terms. Asian indexes did not fare as well due to flare-ups in COVID-19 infections in some countries and China's crackdown on its technology

giants, among other reasons. While many stock markets delivered outsized gains in the high single-digit to mid double-digit range, the MSCI Japan Index and the MSCI Emerging Markets Index, of which China is the largest weight, underwhelmed with increases of 1.1% and 3.3%, respectively. Over the past year, global equity returns were exceptional with index returns ranging from 25% for the MSCI Japan to 53% for the S&P/TSX Composite Index.

In the latest quarter, U.S. small-cap stocks took a breather from their torrid pace of outperformance versus mid- and large-cap stocks since last year, perhaps an indication that the easy gains of the economic reopening have been reaped. The S&P 500 Index surged 10.7% while the S&P 400 Index and S&P 600 Index rose 9.6% and 7.6%, respectively. Value stocks continued to outperform growth stocks as consumer demand and investor confidence improved. The Russell 3000 Value Index's 12.5% return was almost double the Russell 3000 Growth Index's 6.3% gain. The global equity rally was broad-based this past quarter with all 11 sectors posting gains. The growth-stock-heavy Information Technology sector was last with a 5.1% return while the value-heavy Financials sector led with a return of 15.4%. The Financials sector was the top performer over the 12-month period, with a 62.5% return, and the worst performer was Utilities with a 16.1% return.

Exchange Rates
Periods ending May 31, 2021

	Current USD	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)
USD–CAD	1.2070	(5.15)	(5.18)	(12.34)	(2.36)	(1.64)
USD–EUR	0.8178	(1.33)	(0.10)	(9.22)	(1.49)	(1.87)
USD–GBP	0.7039	(1.94)	(3.74)	(13.07)	(2.19)	0.39
USD–JPY	109.4900	2.72	6.04	1.53	0.22	(0.23)

Note: all changes above are expressed in US dollar terms

Canada
Periods ending May 31, 2021

	USD					CAD		
	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	3 months (%)	1 year (%)	3 years (%)
<i>Fixed Income Markets: Total Return</i>								
FTSE Canada Univ. Bond Index TR	4.58	0.84	12.11	6.54	4.52	(0.81)	(1.72)	4.03

U.S.
Periods ending May 31, 2021

	USD					CAD		
	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	3 months (%)	1 year (%)	3 years (%)
<i>Fixed Income Markets: Total Return</i>								
FTSE U.S. Government TR	(0.04)	(2.41)	(0.36)	5.13	3.30	(5.19)	(12.65)	2.65
BBgBarc U.S. Agg. Bond Index TR ¹	(0.14)	(2.29)	(0.40)	5.06	3.25	(5.29)	(12.69)	2.58

Global
Periods ending May 31, 2021

	USD					CAD		
	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	3 months (%)	1 year (%)	3 years (%)
<i>Fixed Income Markets: Total Return</i>								
FTSE WGBI TR	0.05	(2.80)	3.63	4.37	3.08	(5.11)	(9.15)	1.91
FTSE European Government TR	0.24	(3.42)	9.65	4.68	3.54	(4.93)	(3.88)	2.21
FTSE Japanese Government TR	(1.55)	(5.96)	(2.19)	0.21	0.15	(6.62)	(14.26)	(2.15)

Canada
Periods ending May 31, 2021

	USD					CAD		
	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	3 months (%)	1 year (%)	3 years (%)
<i>Equity Markets: Total Return</i>								
S&P/TSX Composite	15.99	20.69	52.66	13.18	12.15	10.01	33.83	10.51
S&P/TSX 60	16.79	21.73	51.55	13.75	12.82	10.77	32.85	11.07
S&P/TSX Small Cap	14.28	25.70	89.12	11.57	10.15	8.39	65.79	8.94

U.S.
Periods ending May 31, 2021

	USD					CAD		
	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	3 months (%)	1 year (%)	3 years (%)
<i>Equity Markets: Total Return</i>								
S&P 500 TR	10.72	12.62	40.32	18.00	17.16	5.01	23.01	15.22
S&P 400 TR	9.60	18.81	56.77	13.71	14.62	3.95	37.43	11.03
S&P 600 TR	7.63	23.15	73.07	12.50	15.89	2.08	51.72	9.84
Russell 3000 Value TR	12.55	18.98	46.34	12.75	12.43	6.74	28.29	10.09
Russell 3000 Growth TR	6.35	6.16	40.51	22.40	21.75	0.86	23.17	19.51
NASDAQ Composite Index TR	4.41	6.98	45.95	23.88	23.93	(0.97)	27.95	20.96

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

Global
Periods ending May 31, 2021

	USD					CAD		
	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	3 months (%)	1 year (%)	3 years (%)
<i>Equity Markets: Total Return</i>								
MSCI World TR *	9.69	11.39	40.63	14.41	14.23	4.68	22.91	11.73
MSCI EAFE TR *	8.81	10.07	38.41	8.23	9.77	3.84	20.98	5.70
MSCI Europe TR *	12.27	13.35	42.52	8.91	9.64	7.13	24.57	6.36
MSCI Pacific TR *	3.13	4.65	31.79	7.04	10.15	(1.58)	15.19	4.53
MSCI UK TR *	11.56	15.29	36.46	2.39	5.44	6.46	19.27	(0.01)
MSCI France TR *	14.10	16.09	52.22	9.52	11.95	8.88	33.05	6.95
MSCI Germany TR *	10.91	11.07	42.44	7.08	9.38	5.84	24.50	4.57
MSCI Japan TR *	1.07	1.58	25.19	6.43	9.70	(3.55)	9.42	3.94
MSCI Emerging Markets TR *	3.28	7.26	51.00	9.65	13.88	(1.44)	31.98	7.08

Global Equity Sectors
Periods ending May 31, 2021

	USD					CAD		
	3 months (%)	YTD (%)	1 year (%)	3 years (%)	5 years (%)	3 months (%)	1 year (%)	3 years (%)
<i>Sector: Total Return</i>								
Energy TR *	7.94	28.50	35.43	(7.77)	(0.31)	3.00	18.37	(9.93)
Materials TR *	13.59	16.07	55.95	13.14	15.70	8.39	36.30	10.49
Industrials TR *	12.18	14.00	50.17	12.08	13.35	7.05	31.25	9.45
Consumer Discretionary TR *	7.62	7.78	52.11	18.91	17.84	2.70	32.95	16.12
Consumer Staples TR *	13.04	5.51	21.45	11.09	7.33	7.87	6.15	8.48
Health Care TR *	8.55	6.72	17.86	15.17	11.85	3.58	3.02	12.47
Financials TR *	15.38	24.94	62.46	9.79	12.34	10.10	42.00	7.22
Information Technology TR *	5.13	5.80	43.23	25.74	27.18	0.32	25.19	22.79
Communication Services TR*	8.59	13.98	43.67	20.92	10.91	3.63	25.58	18.09
Utilities TR *	10.27	2.75	16.11	10.91	8.45	5.23	1.48	8.31
Real Estate TR *	12.93	14.47	29.18	8.58	NA	7.76	12.91	6.03

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

Economic Outlook

Consumer revival awakens inflation fears

Eric Lascelles

Chief Economist
RBC Global Asset Management Inc.

The latest wave of COVID-19 infections is now retreating, allowing governments to incrementally reopen their economies (Exhibit 1). This is a most welcome development.

However, this sunny story is shadowed by two new challenges. The first of these is that inflation has spiked higher. While much of the increase is clearly temporary, not all of it can be so tidily explained. If sustained, persistently high inflation would do damage via eroded purchasing power, more hawkish central banks and higher borrowing costs. The second danger is that a new, extremely contagious Indian variant of the virus could spur further virus waves, much as the emergence of the highly contagious British variant contributed to the spring surge in cases.

Even after considering these risks, we remain reasonably optimistic about the trajectory of the economy and markets over the coming year (Exhibit 2). High inflation should substantially, though not completely, abate over the second half of the year. Vaccines have now reached around half of the population in many developed countries, and are increasingly reaching other countries. This should limit future virus waves. Pent-up economic demand is considerable and beginning to be unleashed as government restrictions fall away. Our business-cycle framework still points to an “early cycle” diagnosis and thus further room

Exhibit 1: Global COVID-19 cases and deaths have been declining

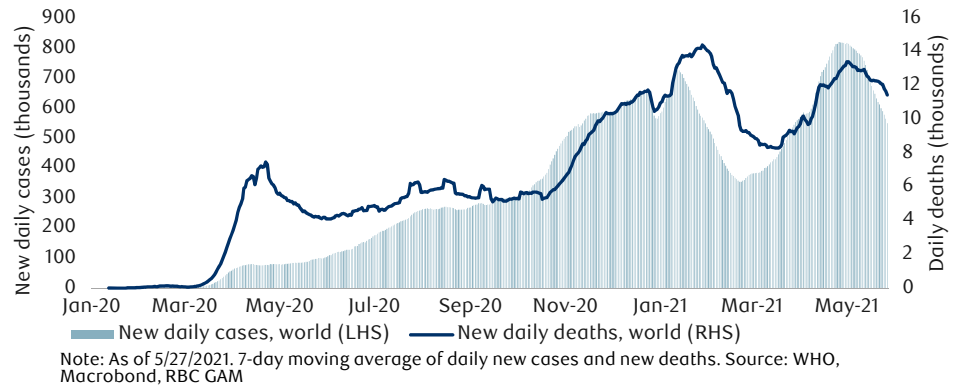


Exhibit 2: U.S. economic activity accelerates as states lift restrictions

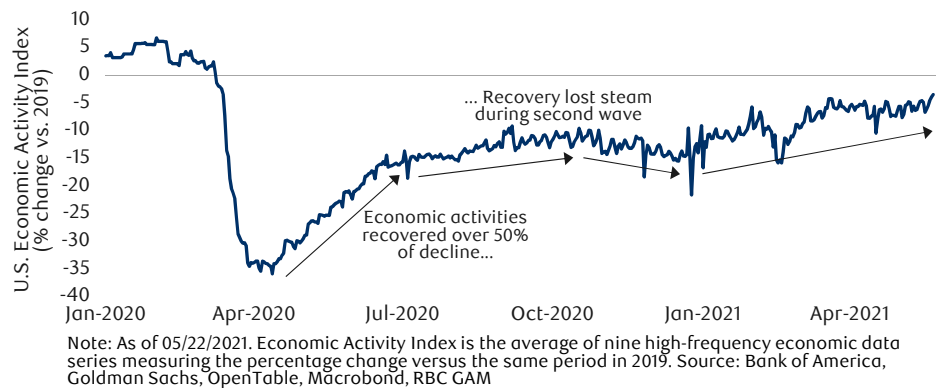


Exhibit 3: U.S. business-cycle scorecard

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

Note: As at 2021-04-29. Darkness of shading indicates the weight given to each input for each phase of the business cycle. Source: RBC GAM

for economic gains, although the cycle is moving more quickly than normal (Exhibit 3).

Looking a little further out, any number of twists and turns remain in store over the next few years. Potential positives include the eventual achievement of herd immunity, the possibility of further fiscal stimulus and a scenario of structurally faster productivity growth. Potential negatives include the risk of a fiscal hangover in 2022 as some spending initiatives expire, the possibility of taper tantrums as central banks begin to publicly muse about withdrawing monetary stimulus, and the rapid rate at which the business cycle is advancing.

Our economic forecasts are mostly at or slightly above the consensus, a marginally less bullish positioning than in past quarters. This is almost entirely because the consensus forecast has itself become more optimistic. The same goes for the financial market outlook: it is still constructive, but incrementally less risk-seeking now that so much is already priced into assets.

Inflation worries

Inflation is rising and now outright high in some countries (Exhibit 4). Of greatest concern, U.S. CPI has now risen to 4.2% on a year-over-year basis, more than double the targeted rate and the highest reading in well over a decade.

We continue to expect quite high inflation over the next several months, moderately higher than normal inflation over the next few years, but

Exhibit 4: Inflation rising in major economies

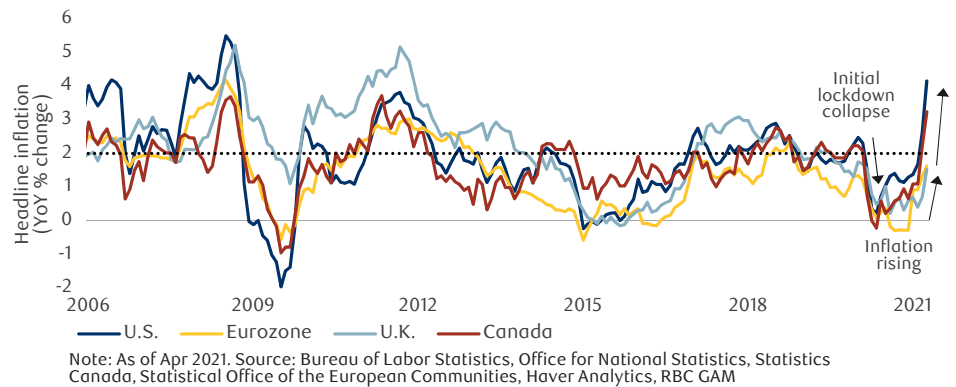
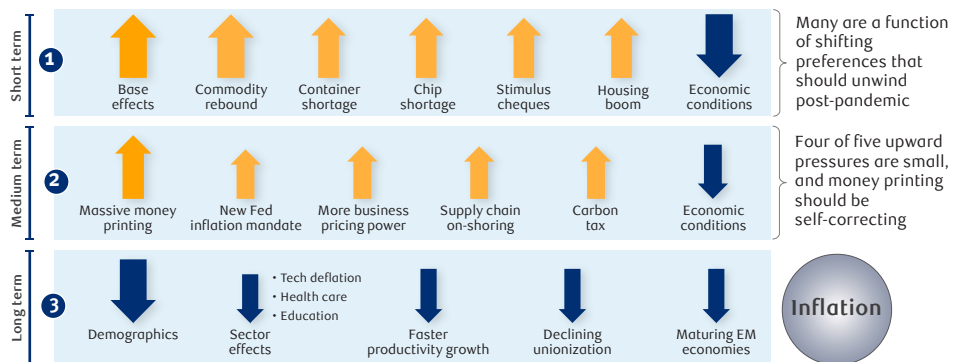


Exhibit 5: Inflation to be quite high in short term, a little high in medium term, normal to low in long term



ultimately normal (or even slightly below normal) inflation over the long run (Exhibit 5).

The recent leap in inflation is due in large part to the confluence of several temporary factors. These include the influence of base effects (low inflation from last year rolling out of the equation), higher commodity prices and an assortment of other smaller drivers such as shortages of shipping containers and computer chips. Stimulus cheques have

prompted many Americans to splurge simultaneously on big-ticket durable goods, driving prices higher. There are also various ways that the housing boom is increasing prices both directly and indirectly. The rebound in energy costs is a disproportionate part of the upward pressure (Exhibit 6).

The latest inflation jump exceeded both our own expectation and consensus estimates. Our forecasts for the coming years have accordingly been revised somewhat higher (Exhibit 7).

While the various short-term drivers appear haphazard in nature, in actual fact most relate to the shifting demand preferences of consumers during the pandemic. With many services temporarily unavailable, people purchased more goods, resulting in acute shortages of certain products. Similarly, in a work-from-home world (and with ultra-low interest rates), housing demand boomed. Some countries such as the U.S. have other idiosyncratic forces at work, such as the inflationary influence of a depreciating U.S. dollar.

As the impact of the pandemic starts to fade, demand preferences should revert at least partially to historical norms. That should allow inflation to retreat toward more normal levels. While previously fallow sectors such as tourism are now beginning to experience demand pressures of their own as consumers rush back, any resulting inflation should be offset by diminished pressure in the sectors that consumers are pivoting away from.

Some pressure should also be taken off demand and prices in the coming months as government stimulus cheques have already been significantly spent.

Over the medium term, we continue to see some upward inflation pressures, though of a milder nature. A key factor is the large-scale money printing conducted by central banks, though in practice most of the extra money has been absorbed back into the central banks in the form of excess reserves (Exhibit 8). Other drivers include the U.S. Federal Reserve's (Fed) new inflation mandate that actively seeks

Exhibit 6: Inflation is now above 2% for a majority of sectors

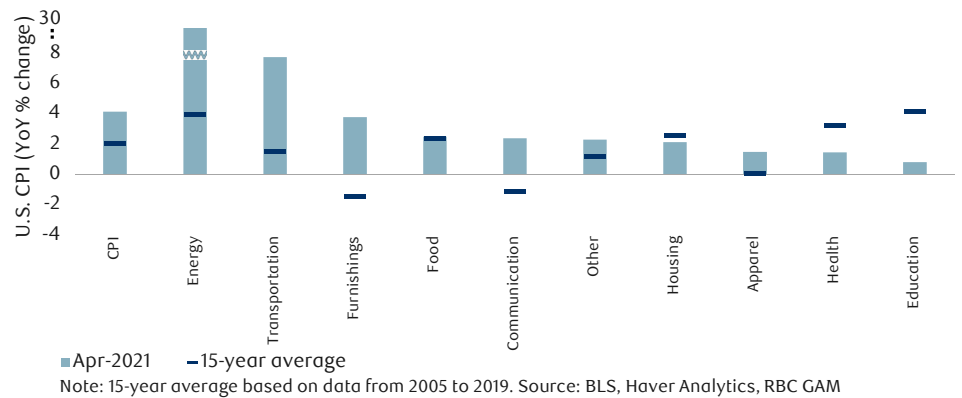


Exhibit 7: RBC GAM CPI forecast for developed markets

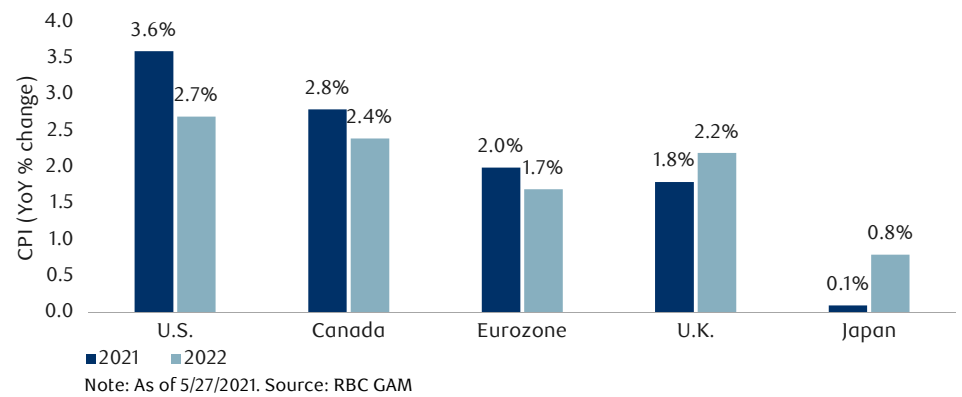
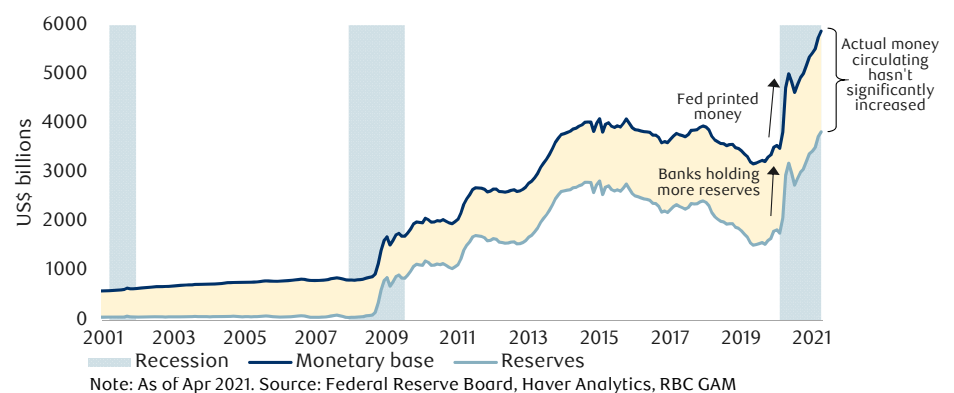


Exhibit 8: Most of Fed's money printing didn't reach the economy



a bit more than 2.0% inflation over the next few years, the prospect of additional business pricing power, the partial on-shoring of certain supply chains and the inflationary effect of higher carbon taxes in countries such as Canada.

In contrast, over the long run, the most compelling drivers are deflationary in nature. Old populations with low fertility rates appear to be profoundly deflationary. The impact of new technologies remains deflationary, and such products constitute a rising share of consumption. Health care and education appear to be structurally less inflationary than in prior decades. We also believe the world may enjoy faster productivity growth in the future – another potentially deflationary force. Other longstanding secular forces such as declining unionization and maturing emerging-market economies also impose further downward pressures on inflation.

Although not a part of our base-case forecast, it is worth considering scenarios in which inflation exceeds our expectations.

One path toward structurally high inflation would be if inflation expectations become stuck at elevated levels, creating a self-fulfilling prophecy. There has indeed been a significant jump in market-based measures of inflation expectations: these now call for outright high inflation over the next several years (Exhibit 9). However, the market outlook for inflation over the longer run – while rising – remains similar to pre-pandemic expectations.

Exhibit 9: U.S. inflation expectations at multi-year high

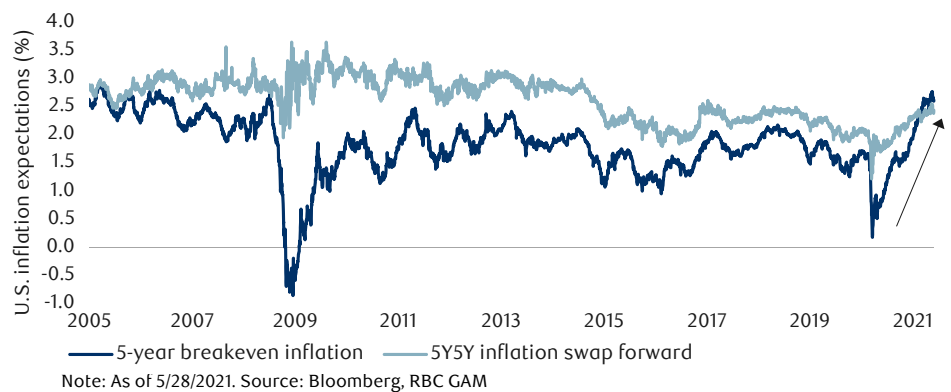
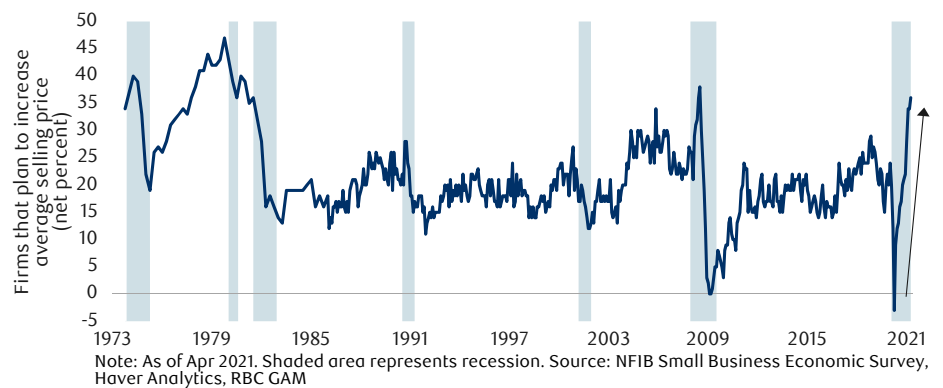


Exhibit 10: The percentage of businesses that plan to raise prices is at its highest since the financial crisis



Second, inflation could become a sustained problem if a wage-price spiral were to unfold. Corporations do presently possess pricing power and appear inclined to pass along most of the considerable increase in their input costs to customers (Exhibit 10). However, there is only middling wage pressure outside of a handful of low-skill sectors. The absence of surging (and inflation-sensitive) wages should short-circuit any wage-price spiral (Exhibit 11).

Third, inflation could become a chronic problem if commodity prices were to continue rising significantly. Arguments in favour of another commodity supercycle include China's enormous appetite for commodities and still impressive growth rate, the prospect of India following in China's growth footsteps over the next few decades, the possibility of a post-pandemic infrastructure boom, and a wholesale shift toward green-energy technologies.

But a commodity supercycle is not a certainty, as commodity prices already significantly reflect these optimistic expectations, there is some spare mining capacity that will return as the pandemic fades, the switch to green technologies will take several decades, and it is far from clear that oil prices – traditionally a key driver of any commodity cycle – can fully participate given forecasts that global oil demand will begin to fall in the 2030s. It is also important to appreciate that a key Chinese metric, the country’s credit impulse, just swung sharply negative – not normally consistent with a commodity boom (Exhibit 12).

The bottom line is that inflation has been running quite hot and exceeding expectations, but is very likely to cool somewhat over the second half of 2021. But such pressures won’t completely go away for a few years, and there are a trio of scenarios in which inflation could prove a more persistent problem for the economy, for central banks and for asset valuations. Whereas inflation was an afterthought for the past decade, it now requires some attention.

COVID-19 fades (but risk of another wave)

A new wave of COVID-19 infections emerged over the past quarter, driven mainly by the spread of a more contagious British virus variant, but also arguably due to the premature easing of restrictions after the prior wave, mounting social-distancing fatigue and possibly seasonal factors (Exhibit 13).

Fortunately, this wave is now abating in most countries. Developed nations have made significant progress, and

Exhibit 11: Wage growth has declined during pandemic when controlled for sector

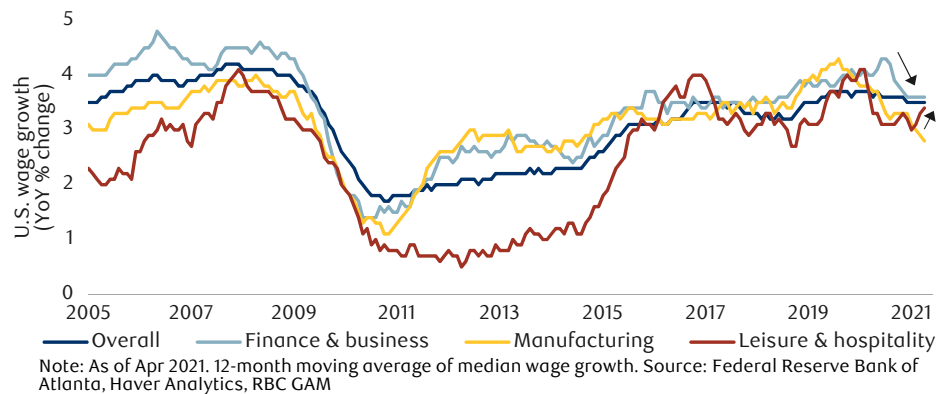


Exhibit 12: Chinese credit impulse turned negative

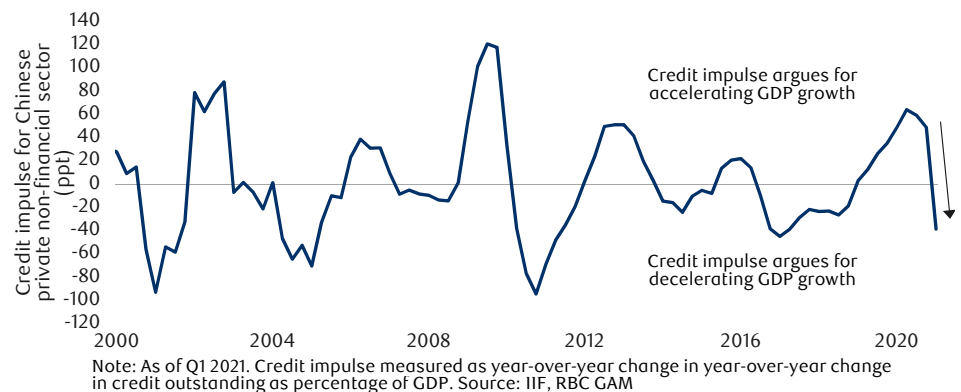


Exhibit 13: The factors driving repeated virus waves – this is hopefully the last major wave for developed markets

	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
Social distancing rules	Significant increase	Increase	Decrease	Increase	Decrease	Increase	Significant increase
Social distancing fatigue	Decrease	Decrease	Decrease	Increase	Decrease	Significant increase	Significant increase
Seasonal factors	Decrease	Increase	Decrease	Increase	Decrease	Increase	Decrease
Holiday socializing	Decrease	Decrease	Decrease	Significant increase	Decrease	Increase	Increase
Schools	Significant increase	Decrease	Decrease	Increase	Decrease	Increase	Decrease
More contagious variants	Decrease	Decrease	Decrease	Increase	Decrease	Significant increase	Significant increase
Immune population	Significant increase	Significant increase	Increase	Increase	Decrease	Decrease	Decrease
OVERALL	Significant increase	Significant increase	Decrease	Increase	Decrease	Increase	Significant increase

Effect on pandemic: ■ Significant increase ■ Increase ■ Decrease ■ Significant decrease ▲ Present

Note: As at 2021-04-24. Vertical height of each category reflects its relative importance. Source: RBC GAM

emerging-market countries are finally now improving as well (Exhibit 14). There are, of course, exceptions, with South Africa now struggling and U.K. cases now creeping higher again.

Europe, which was disproportionately affected by the latest wave, is now healing almost everywhere, including in Germany (Exhibit 15). That said, the number of daily infections is not yet low enough for us to give the all-clear.

Looking ahead, the main pandemic risk revolves around a subtype of the Indian variant. It appears to be 50% more contagious than the U.K. variant, which was itself around 50% more contagious than the original form of the virus. It is distressing that a country like the U.K. is recording an accelerating number of Indian variant infections despite being among the world leaders in vaccinations, possessing an unusually high rate of naturally acquired immunity, having imposed unusually stringent restrictions until quite recently, and having successfully tamed the highly contagious U.K. variant (Exhibit 16).

It is some consolation that India, which was until recently setting world records for new cases per day, is now beginning to improve despite the presence of the problematic Indian variant (Exhibit 17). Further, it appears that most of the Indian variant infections recorded in the U.K. were among unvaccinated people – vaccines are thought to have some efficacy against this new variant.

Nevertheless, there is a real risk of another virus wave in the coming months given this more contagious variant, or even other little known variants such as the one now brewing in Vietnam.

Exhibit 14: Latest COVID-19 wave receding in both developed and emerging countries

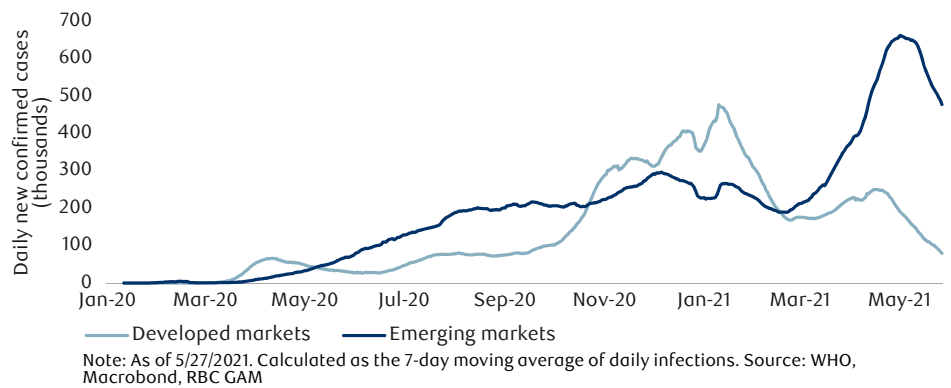


Exhibit 15: COVID-19 cases and deaths dropped significantly in Germany

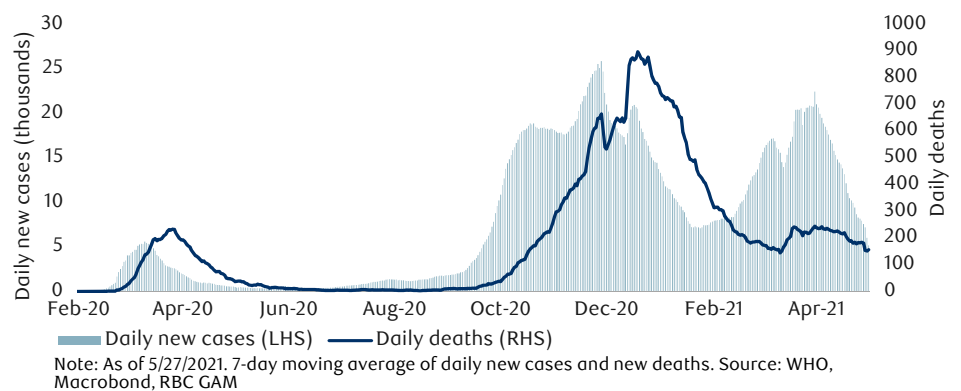
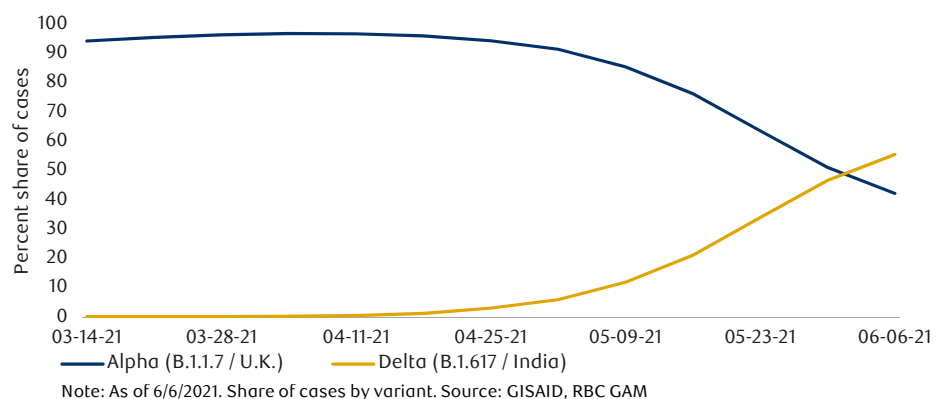


Exhibit 16: Share of Indian variant in U.K. rising at alarming speed



Vaccines to the rescue

Governments have now administered 1.9 billion doses of COVID-19 vaccine. This is a heroic accomplishment – in both a scientific and a logistical sense – and yet woefully too little given a global population of nearly 8 billion and, in most cases, the need for two doses per person.

Unsurprisingly, inoculations have skewed heavily toward the world’s richest countries (Exhibit 18). Several of these can now boast more than 80 doses administered per 100 people. In contrast, many countries have barely begun to vaccinate their populations. This disparity is partly due to differing abilities to afford vaccines and varying levels of geopolitical clout, but also because scientific development, corporate ownership and/or physical vaccine production are concentrated in developed nations.

The supply of vaccines is set to continue accelerating over the next several quarters, with the bulk of the developed world likely to be inoculated by the end of the summer and emerging nations over the remainder of the year and into 2022.

The effectiveness of COVID-19 vaccines has generally been high, with most of the countries near the top of the vaccine rankings now enjoying plummeting caseloads (Exhibit 19).

However, the vaccines appear to be somewhat less effective against certain variants, and some vaccines are potentially much less effective. These complications may help to explain why a few countries that have vaccinated the great majority of their populations, such as Bahrain and the

Exhibit 17: New infections in India have fallen but deaths remain elevated

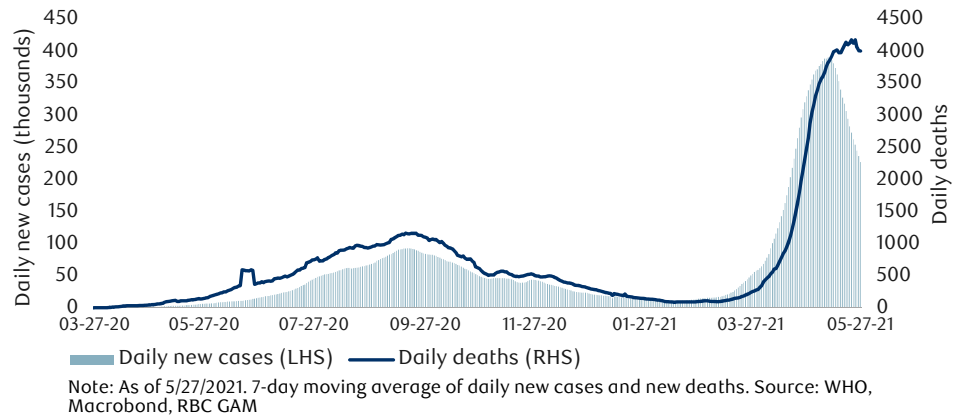


Exhibit 18: Wealthy nations at the forefront of vaccination

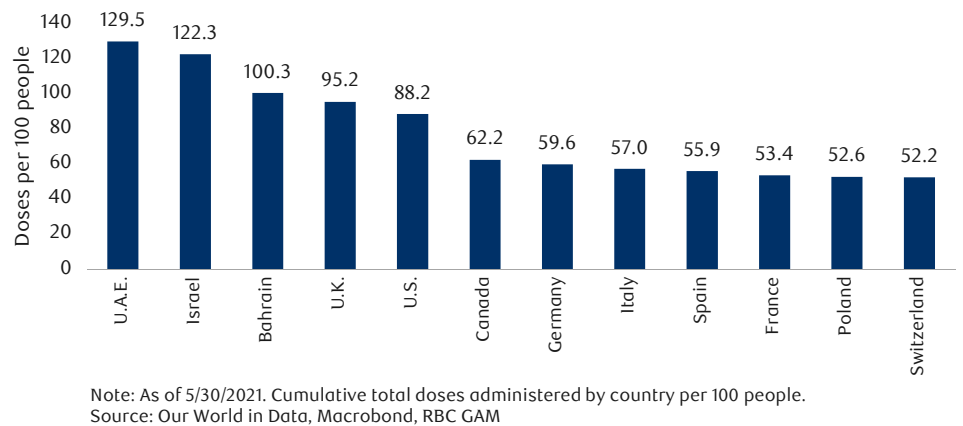
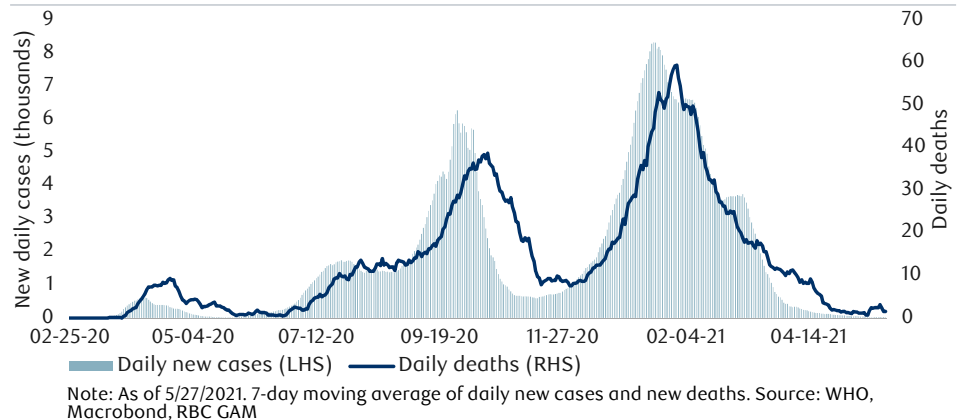


Exhibit 19: COVID-19 caseload and deaths in Israel have remained subdued



Seychelles, are still suffering a high level of infection.

In short, vaccines are the key tool in beating back the pandemic, but not a complete panacea, especially as more problematic variants continue to pop up. Whereas herd immunity from the original form of the virus might have been achieved with just 60% to 65% of the population possessing immunity, it may take more than 80% immunity to vanquish the Indian variant. This is a potentially impossible hurdle. Accordingly, while the need for social-distancing restrictions is declining (Exhibit 20), some limited restrictions will have to remain for the foreseeable future.

Varied economic revival

The short-term economic story varies substantially by country.

Even as more contagious variants began to circulate widely this spring, the U.S. refused to lock down significantly and yet managed to pare its infection rate thanks to its fast-moving vaccination campaign (Exhibit 21). In turn, the U.S. economy barely missed a beat during the latest wave, now boasting of activity levels in the vicinity of its pre-pandemic position (Exhibit 22).

The U.K. has considerably more ground to cover before its economy fully revives, but also avoided much of the latest wave and is in rapid-recovery mode.

Other regions that were not as far along in the vaccination process, including Canada, Japan and many European Union (EU) nations, had to engage in a third lockdown. Even

Exhibit 20: Reduction in social interaction necessary to control virus at different rates of population immunity

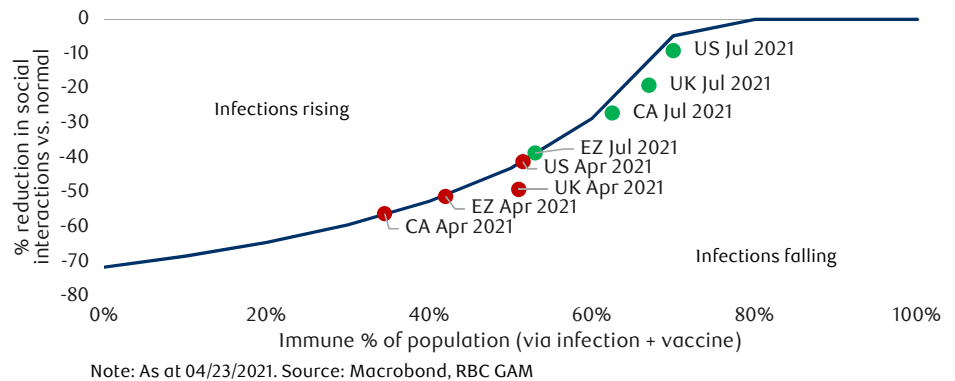


Exhibit 21: U.S. has successfully quelled the latest wave

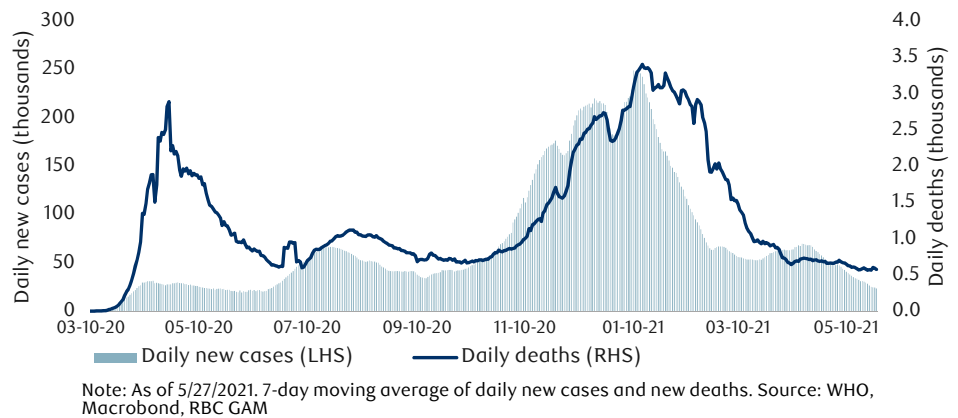
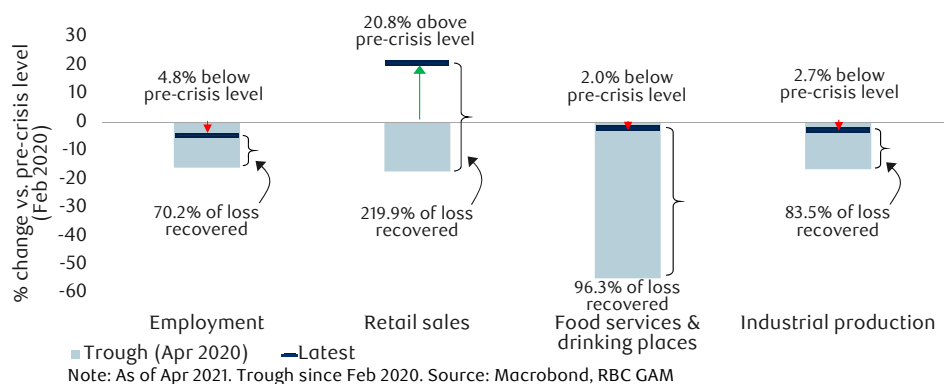


Exhibit 22: Significant U.S. recovery has already taken place



though many of these countries are now themselves reopening, there is an unusually large gap between countries that are almost entirely open and those that are considerably less so (Exhibit 23).

Conversely, Canada, Japan and the EU suffered setbacks that they are now beginning to recover from. Fortunately, the second wave in late 2020 showed that the economic pain is fairly mild from such mini-lockdowns.

Public policy veers in all directions

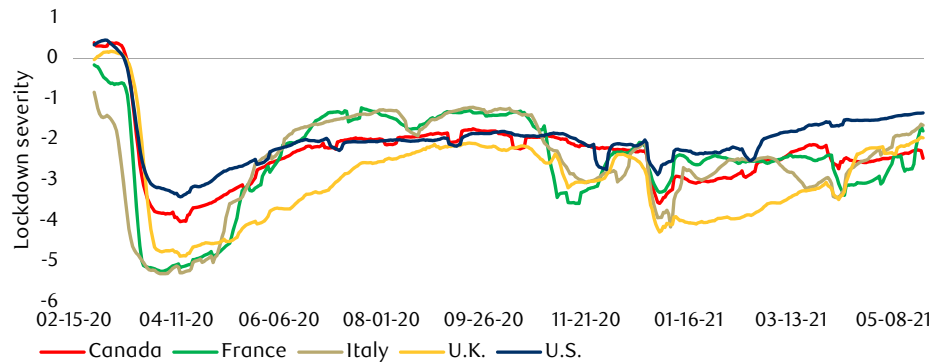
Massive monetary and fiscal stimulus were instrumental in limiting the economic damage during the worst of the pandemic and in aiding the subsequent economic rebound.

Now, the policy environment is becoming more complicated. Some policymakers are continuing to deliver major new stimulus, while others are beginning to pull back.

Most central banks remain in maximum stimulus-delivery mode, with ultra-low policy rates and quantitative easing. The majority of fiscal policymakers also maintain special support mechanisms for the unemployed and affected businesses.

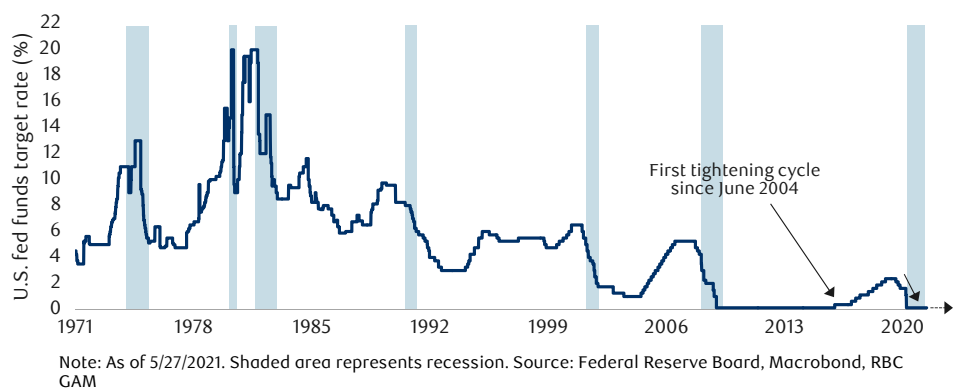
Some countries are even set to add more fiscal stimulus. The U.S. delivered a major fiscal-stimulus package at the end of 2020, another in early 2021, and is now debating another one or even two multi-trillion dollar initiatives. Infrastructure plans are a major focus going forward – a classic policy choice as the rebuilding process begins after an economic crisis.

Exhibit 23: Lockdown measures eased as countries saw improvement in new infections



Note: Based on latest data available as of 5/24/2021. Deviation from baseline, normalised to U.S., and smoothed with a 7-day moving average. Source: Google, University of Oxford, Macrobond, RBC GAM

Exhibit 24: U.S. fed funds rates trajectory



Note: As of 5/27/2021. Shaded area represents recession. Source: Federal Reserve Board, Macrobond, RBC GAM

However, not all policymakers are pushing further in this direction, and some natural policy headwinds are arising.

China appears to be edging toward more restrictive economic policies as the country slows credit growth in response to housing-market strength.

While monetary policy in the developed world remains extremely stimulative and is unlikely to tighten significantly in the near term (Exhibit 24), some change is underway.

Canada has now scaled back the pace of quantitative easing by a quarter and is musing about rate hikes for the second half of 2022. Although Canada's central bank is ahead of most of its peers in these steps, the Canadian economic context is far from unique. The Fed has a greater tolerance for temporary periods of higher inflation, but is nevertheless now internally discussing what any tapering in monetary policy might look like. Central-bank-run bond-buying programs could begin to ebb over the coming year, with 2022 or 2023 in

play for higher policy rates, especially given the clip at which economies are rebounding and inflation has risen.

Aside from the U.S., fiscal stimulus is beginning to fade in many countries. Much of this is benign, simply reflecting a diminishing need for government help as businesses and households recover. But other programs will expire more abruptly over the coming year, imposing an active drag on economic growth. Fiscal math is frustrating: if a government spends a billion dollars one year and then \$500 million the next, economic growth will be weaker than normal in the second year because the amount of spending is declining, even though it has not vanished altogether.

Because fiscal stimulus in 2020 and early 2021 was enormous, the potential fiscal drag thereafter is quite large. But it may not be quite as enormous as imagined, as households and businesses have saved much of the stimulus delivered so far. This has two helpful implications. First, it means that the economy has less distance to fall as the support goes away, and, second, it means that households and businesses can use their excess savings to smooth their consumption through an otherwise rocky period.

There should be enough natural buoyancy for economies to continue recovering even as these policy supports fade. The gradual removal of stimulus may even be helpful in limiting any inclination for economies or inflation to overheat. This policy pivot is nevertheless one of several key risks to the growth outlook.

Exhibit 25: Chinese economy completely recovered

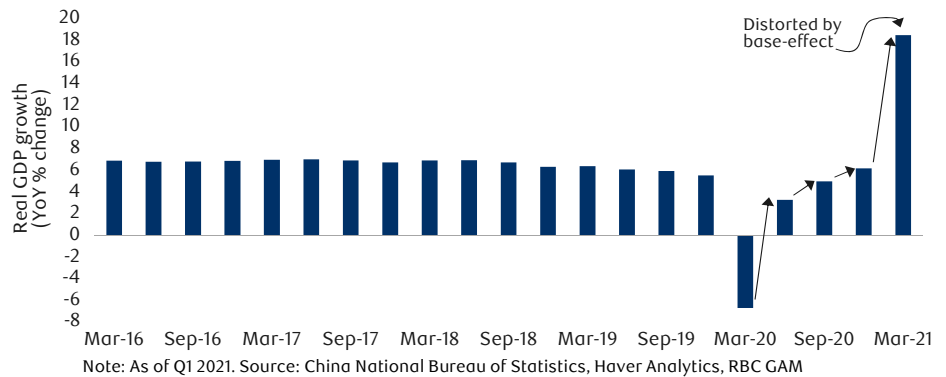
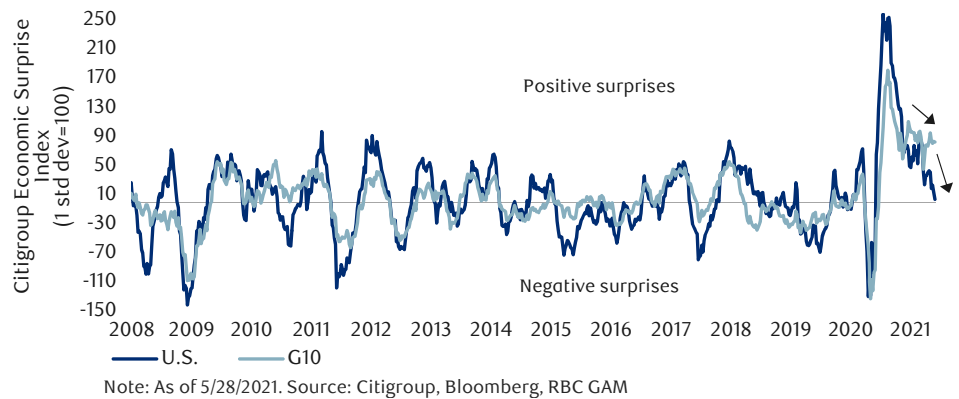


Exhibit 26: Global economic surprises remain positive, though slipping lower



There is an additional U.S.-specific policy risk for investors, which is that the White House is proposing significant tax hikes to help pay for infrastructure and green initiatives, with many targeted at corporations and investments. Both would moderately reduce after-tax investment returns. These seem more likely than not to be implemented, but they are not certain and any implementation will probably be watered down given the razor-thin Democratic Party majority in the Senate.

Economic forecast

The clear winning bet over the past year has been on above-consensus economic growth, and some such bets are worth extending. Helping to inform this, China has been a bellwether in many regards across this pandemic, including in its rapid economic normalization (Exhibit 25).

However, a significant rise in market expectations tempers our enthusiasm a little, with economic surprises no longer so reliably positive (Exhibit 26).

Accordingly, our own forecasts are now a mix of on-consensus and modestly above-consensus predictions.

In absolute terms, it is still reasonable to expect rapid growth over the coming year as vaccines extend their reach, the pandemic fades and economies recover. The flow of news is primarily positive and now back to pre-pandemic territory (Exhibit 27). We continue to anticipate little economic scarring from the pandemic.

It is clear, nevertheless, that the most explosive period of growth has come and gone.

Some countries – including most of the EU and Canada – had to lock down again during the recent third wave, temporarily slowing their progress. We also budget for the possibility of a further stumble over the summer should the Indian variant lift global infection rates again.

Financial conditions remain quite friendly (Exhibit 28), though we assume some tightening from central banks in 2022. Fiscal stimulus is also set to morph into fiscal headwinds at around that time, as discussed earlier. These are both reasons why economic growth should decelerate next year (Exhibit 29).

The U.S. economy is set to be among the fastest growing in 2021, at 6.4%, due to the country’s vaccination success, enormous fiscal stimulus and fewer social-distancing restrictions. Remarkably, the U.S. recently surpassed its pre-pandemic level of output and is on track to eliminate any remaining economic slack by early 2022 (Exhibit 30).

Exhibit 27: Economic sentiment is now positive

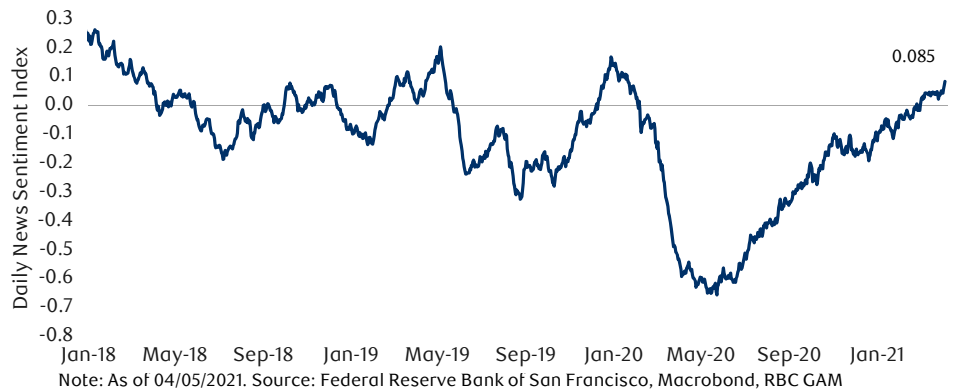


Exhibit 28: Financial conditions still extremely stimulative

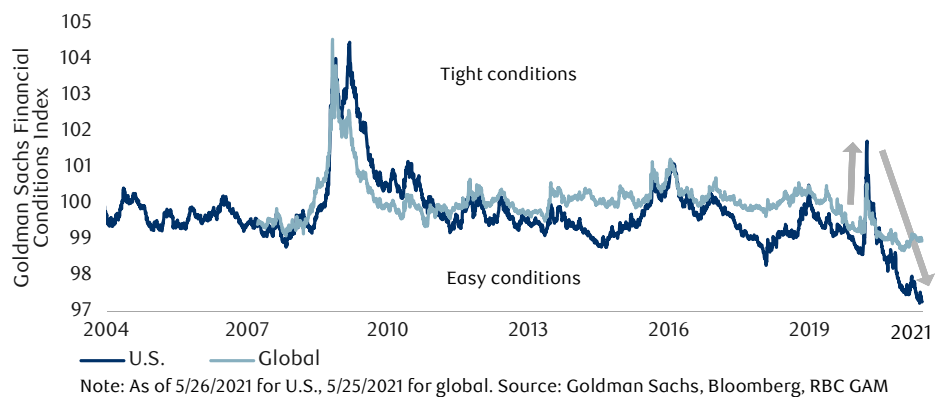
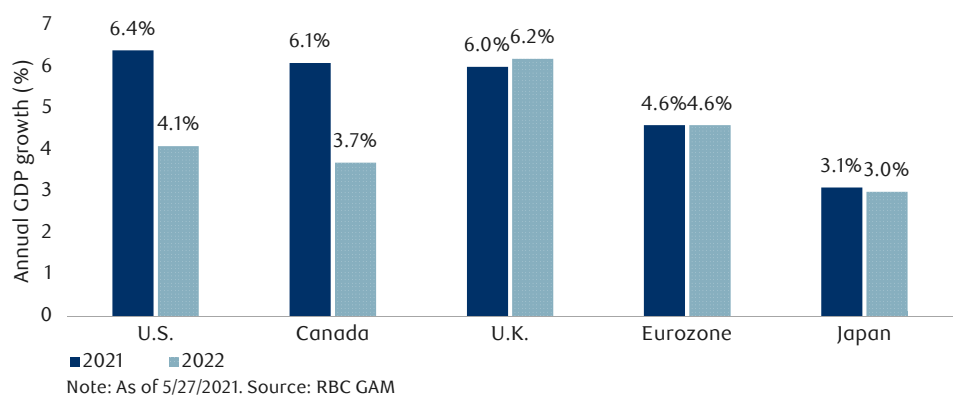


Exhibit 29: RBC GAM GDP forecast for developed markets



As the second half of 2021 unfolds, other countries that have lagged the U.S. should begin to play catch-up, with their vaccination efforts paying belated dividends and economic restrictions abating (Exhibit 31). While our U.S. GDP forecast is roughly in line with the consensus, our eurozone and U.K. forecasts are particularly above the consensus. Still, it will take longer for these economies to return to their pre-pandemic levels – likely in early 2022 – and then several further quarters for the remaining slack to be eliminated.

The pandemic has hit emerging-market economies hard, both with regard to lives lost and economic output foregone. The main contours of the economic trajectory are the same as for developed nations, with 2021 a year of rapid growth, followed by some deceleration in 2022 (Exhibit 32). Our 2021 forecasts are mildly above-consensus for China and a little below the consensus for India, with the others roughly in line. Despite its recent challenges, India still appears poised for structurally strong growth over the coming decades.

Canada’s stuttering recovery

Canada experienced a more intense COVID-19 third wave than the U.S., mainly because of the country’s sluggish start to the vaccination process. The economy accordingly underperformed the U.S. in April and May, much as it did at the turn of the year during the second wave (Exhibit 33).

Exhibit 30: Still considerable room for catch-up growth in coming years

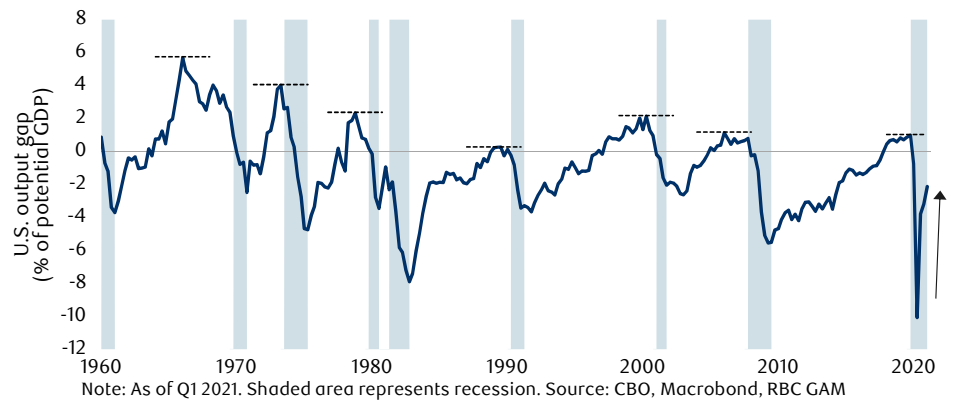


Exhibit 31: Eurozone has performed worse than U.S. across pandemic

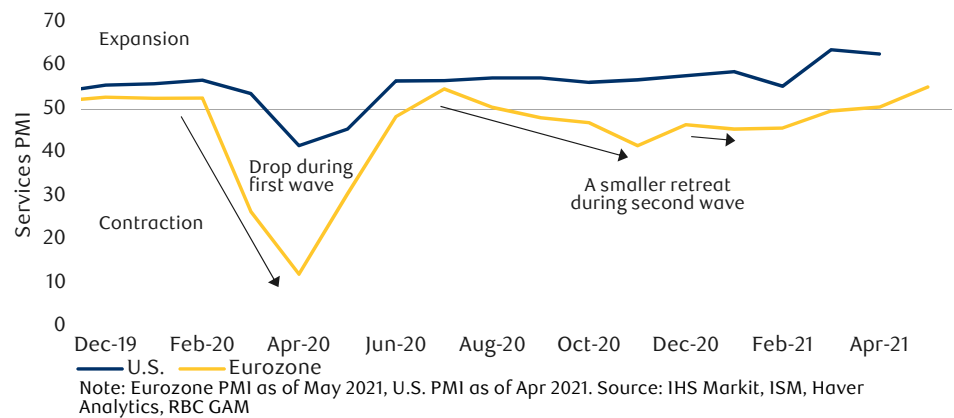
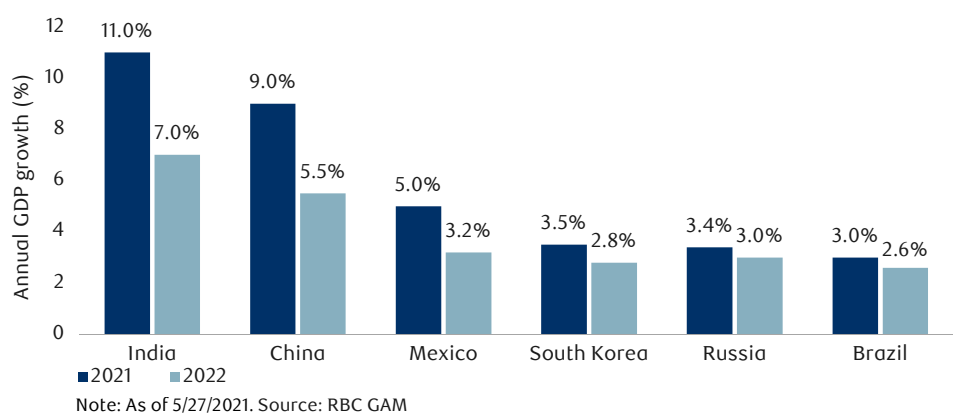


Exhibit 32: RBC GAM GDP forecast for emerging markets



But the rate of infection is now in free fall thanks to stringent restrictions and accelerating (and targeted) vaccinations (Exhibit 34).

Despite the third-wave setback, the Canadian economy has staged a significant recovery from the worst of the pandemic (Exhibit 35). A further bounce should now be possible over the summer as consumers make up for time lost to the second and third waves. While the stronger Canadian dollar represents a headwind, it is more than offset by the natural buoyancy of a recovering economy, new Canadian fiscal stimulus, a significant spillover from U.S. stimulus and the rebound in commodity prices. Any increase in U.S. taxes would narrow Canada's competitiveness shortfall with the U.S.

Our growth forecasts for Canada of 6.1% in 2021 and 3.7% in 2022 should bring the country's economy back to its pre-pandemic peak in the fall of this year, with the remaining economic slack vanishing before the end of 2022. The inflation trajectory is akin to the U.S., but less extreme in the near term.

Canada's housing market has been a particular source of economic strength. Home prices have increased by an incredible 23% since the start of the pandemic as households prioritized more living space. Whereas the pairing of lower mortgage rates and higher home prices resulted in improved affordability in the U.S. housing market, the opposite has proven true in Canada (Exhibit 36). Housing affordability is now at its worst level in more than a decade. This would seem to suggest less upside for Canadian housing going forward,

Exhibit 33: Canadian businesses shuttered again during third wave

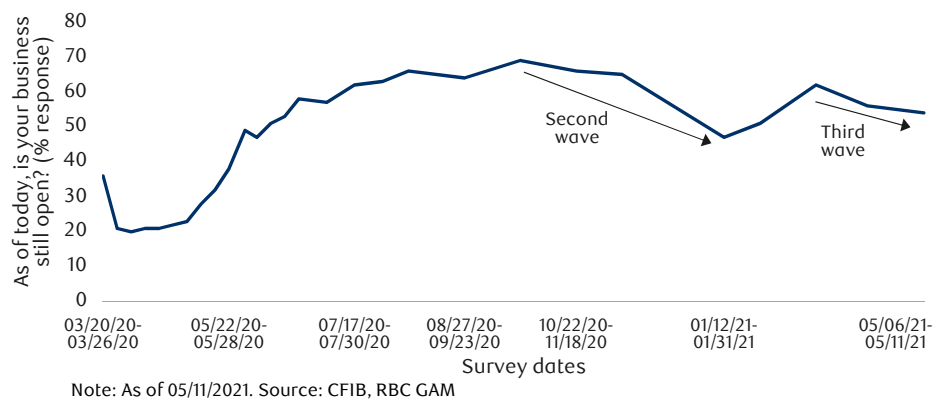


Exhibit 34: Canada now over the peak of the third wave

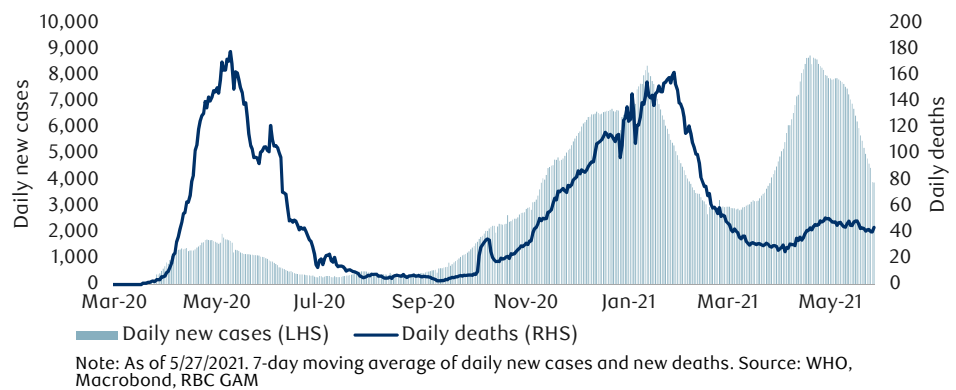
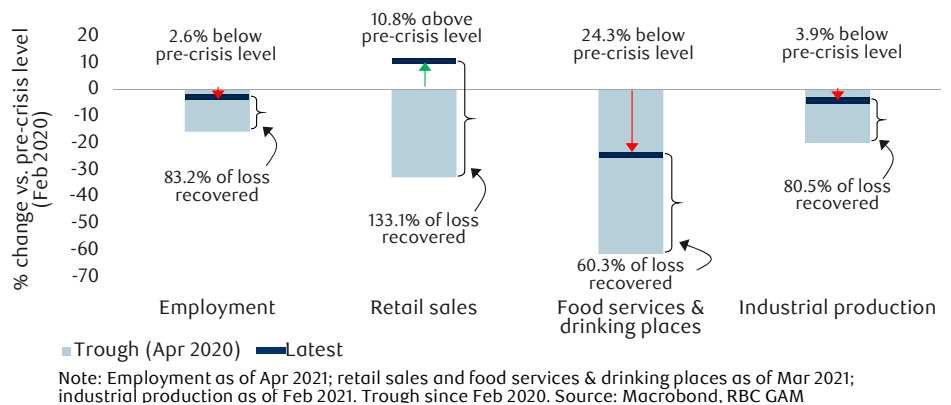


Exhibit 35: Significant progress made in Canada



though falling unemployment rates and a planned immigration boost may buffer any softness even as the pandemic-driven appetite for housing fades.

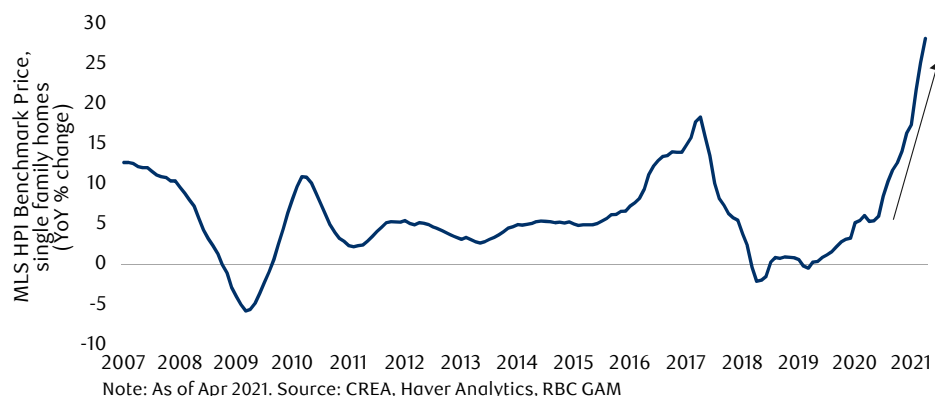
Bottom line

In conclusion, we anticipate rapid, on- or modestly above-consensus growth in 2021, followed by slower but still good growth in 2022. Key supports for this view include the fact that economies have proven persistently more buoyant than expected throughout the recovery, permanent scarring from the pandemic appears to be limited, recent virus waves have done limited economic damage, vaccination efforts are proving highly effective and there is considerable pent-up demand set to be unleashed.

Risks to this view include the possibility of additional virus waves emanating from new variants, the possibility of persistently high inflation, a scenario in which the 2022 fiscal drag is worse than anticipated, and the risk that markets might rebel against the removal of monetary supports.

Over the longer run, we continue to believe that many of the distortions to daily life imposed by the pandemic

Exhibit 36: Canadian home prices surge on demand and ultra-low interest rates during pandemic



will fade (Exhibit 37). Economic variables should fully normalize, and the appetite for services, walk-in retail and public transportation should mostly rebound quickly. Other factors may take a few years to normalize, but downturns should eventually revive, inflation should eventually settle down, and so on. Only a few changes are likely to prove permanent, including higher levels of public debt, a lower level of business travel and a moderately greater inclination to work from home.

We also posit that productivity growth may prove faster over the coming decades than it was over the past 10 years. This is not quite as remarkable as it first seems given that productivity

gains were unusually paltry over the 2010s. Nevertheless, any revival would be a welcome development given the centrality of productivity growth in increasing standards of living and driving corporate profits.

Arguments in favour of faster productivity growth include a pandemic-induced productivity leap due to advances in remote working, online commerce and automation; the scope for a surge in capital expenditures as the recovery proceeds; the impressive rate of scientific progress underway in key fields; and China's newfound position at the technological frontier, from which it can begin to meaningfully contribute to future innovation.

Exhibit 37: Lasting implications of COVID-19 – few implications are truly permanent and most of those should partially reverse

	Permanent	Multi-year	Short-lived
No reversal	More public debt	Rural/Suburbs > Downtowns	Less socializing, physical contact, personal travel
	More automation	Lower LT return on investments?	Higher unemployment
Partial reversal	Online > Brick and mortar	Larger government	Lower population growth (deaths, less immig., baby bust = slower GDP growth / housing)
	Commercial real estate weakness	Higher inequality	Less innovation (= slower GDP growth)
	Less business travel	More private debt / default risk	Goods > services
	More skittish/prepared for future viral outbreaks	More inflation	Big business > Small business
		Supply chain on-shoring	Private transportation > Public transportation
Significant reversal	Lower interest rates	Human capital loss (school closures & unemployment)	
	More working from home	Less monetary policy independence	
	More resources for low prob./ high impact risks		
		Complete reversal	

Note: As at 2021-02-17. Source: RBC GAM

Market Outlook

Strengthening economy extends bull market

Eric Savoie, MBA, CFA

Investment Strategist
RBC Global Asset Management Inc.

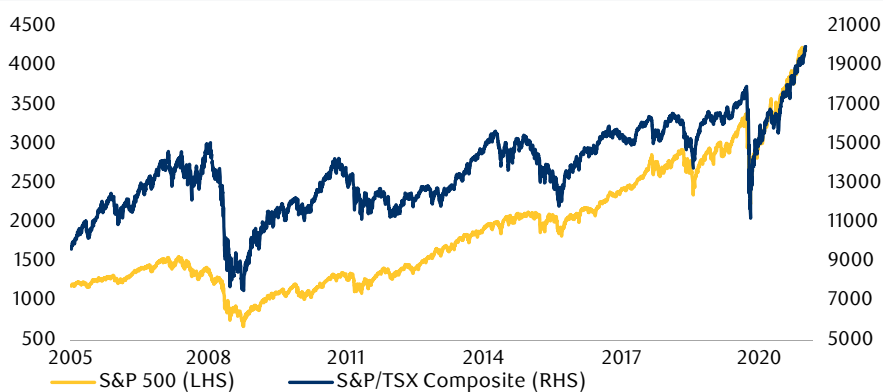
Daniel E. Chornous, CFA

Chief Investment Officer
RBC Global Asset Management Inc.

Just over a year since the coronavirus led to the deepest recession since the 1930s, it may seem difficult to comprehend that equity markets would be rallying to record highs. But the world has responded in remarkable ways to the pandemic: policymakers delivered massive support with little hesitation; vaccines were developed in record time; work from home became ubiquitous; spending shifted from bricks and mortar to online; and the economy carried on amid all of the disruption. The S&P 500 Index has climbed nearly 90% from its March 2020 low and the S&P/TSX Composite Index nearly 80%, delivering tremendous gains for investors and more than recovering any losses from last year's fierce, but short-lived, bear market (Exhibit 1). In our view, U.S. stock markets are richly valued, but not in a bubble. Equities are fundamentally supported by a solid and improving macro-economic backdrop. Importantly, equity markets outside the U.S. are generally much more attractively valued.

The economy is in the early stages of a new business cycle and activity is flourishing as the rebound from the pandemic continues. Pent-up demand following a year of lockdowns, rock-bottom interest rates and ample fiscal and monetary ease are fueling the strong recovery. With the economy

Exhibit 1: Equity-market indexes
Price index



Note: As of June 3, 2021. Source: Bloomberg, RBC GAM

heating up, inflation is a growing concern among investors, but we believe the near-term spike in prices is transitory and that structural forces should ultimately bring inflation back down over the longer term.

In financial markets, bond yields have trended mostly sideways for the past quarter and investors could be locked into low single-digit returns for sovereign bonds over the next year, and maybe for an extended period. The outlook for fixed-income assets is not particularly attractive and, in our view, stocks offer better upside. We recognize, however, that with some equity market valuations at extreme levels, strong earnings growth will be critical to sustaining the bull market. We believe that the earnings required to validate current valuation levels are likely to be delivered.

We are comfortable taking on a healthy degree of risk in this environment of strong growth, low interest rates and incredible policy support. Moreover, the prospect for returns improves outside of North America as we believe

that Europe and emerging markets offer superior valuations. We are maintaining our overweight position in stocks and underweight allocation to bonds. During the past quarter, we trimmed our equity exposure by 50 basis points recognizing elevated stock valuations and narrowing risk premiums, but remain firmly biased toward risk assets. For a balanced global investor, we currently recommend an asset mix of 64 percent equities (strategic neutral position: 60 percent) and 35 percent fixed income (strategic neutral position: 38 percent), with the balance in cash.

Economic strength confirmed by a variety of indicators

A variety of indicators are consistent with the solid economic backdrop. The so-called "Dr. Indicators" displayed in Exhibit 2 were particularly useful during the financial crisis and were among the first to surge going into the subsequent economic recovery. We are seeing this happen again in the current cycle, with the South Korean stock market index (KOSPI), copper prices, the

Canadian dollar and the Baltic Freight Index all soaring to well above their pre-pandemic levels. These readings provide a real-time pulse on the economy and are signaling a continuation of the current advance.

Furthermore, the Duncan Leading Indicator (DLI) suggests that there is little chance of another recession in the immediate future. This composite, based on changes in consumption, investment, and domestic and international sales, has in the past provided a reliable forecast for U.S. growth. The DLI has peaked an average of 12 months in advance of GDP (Exhibit 3). The index's rise to a new high in the most recent quarter suggests the next recession is at least 12 months away. While shocks are always a possibility,

the Duncan indicator points to at least another year of economic growth, in line with our view that the expansion is still in an early stage.

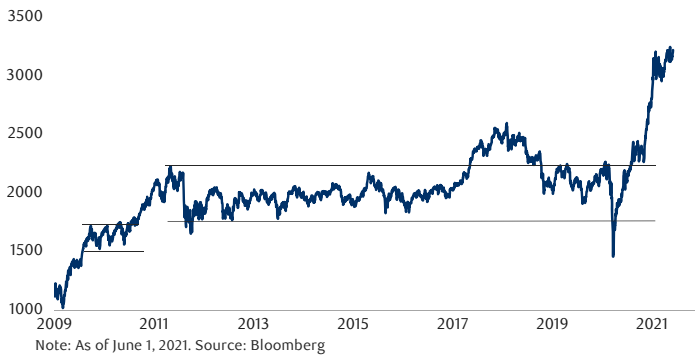
Markets are relatively calm after last year's panic

The relative calm in financial markets represents a significant contrast to last year's panic. The widespread administration of COVID-19 vaccines and clarity with respect to the economy's trajectory has comforted investors and ultimately led to a decline in the volatility index (VIX).

Volatility could remain low for an extended period as suggested by the relationship between the yield curve and

EXHIBIT 2: 'Dr. Indicators'

Korean stock-price index (KOSPI)



Copper – COMEX U.S. cents per pound



Baltic Dry Freight Index



CAD/USD exchange rate



the VIX. Exhibit 4 plots the spread between 3-month and 10-year Treasury yields – which has been reversed on the chart and lagged by 30 months – alongside the VIX. The two lines on the chart have a fairly good fit, and the fact that the yield curve has been steepening in recent quarters suggests that relatively low volatility can be sustained for at least a couple of years.

Another sign of benign market conditions is the fact that credit spreads are at their tightest levels since before the pandemic (Exhibit 5). The behavior of credit markets is often a leading indicator of financial-market stress as problems are frequently signaled in advance by movements in high-yield bond spreads. Our research suggests that the durability and depth of equity-market corrections tend to be minimal if credit spreads remain stable. Instances in the last few months where stocks encountered challenges have not been accompanied by a similar correction in credit markets. Spreads remained very tight and, ultimately, stocks resolved to the upside. Sustaining tight spreads in the high yield bond market will continue to indicate a bullish outlook for stocks.

Inflation is perking up

One potential problem for investors is that inflation is rising and there is a risk that expectations become anchored at elevated levels. Prices of fuel, housing and commodities are surging and there is a recognition that consumer-price pressures are mounting. Exhibit 6 shows that inflation expectations in Europe, Canada and the U.S. have indeed risen, but only to their very long-term averages. We continue to believe

Exhibit 3: Duncan Leading Indicator

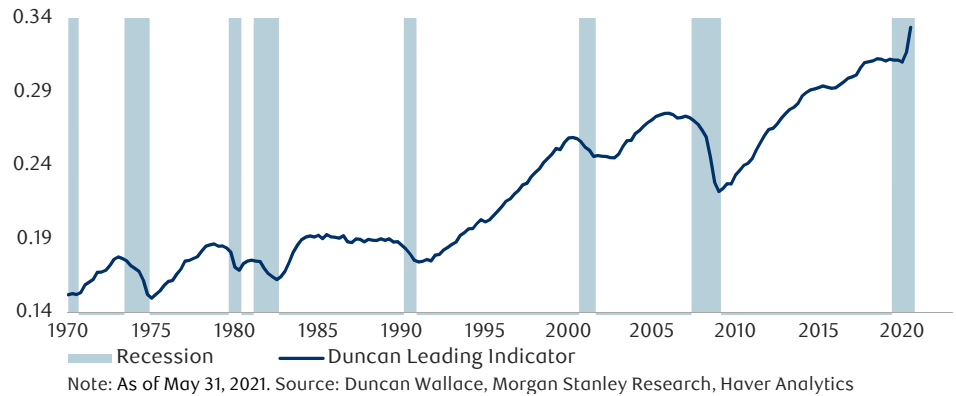


Exhibit 4: U.S. yield curve vs. VIX volatility

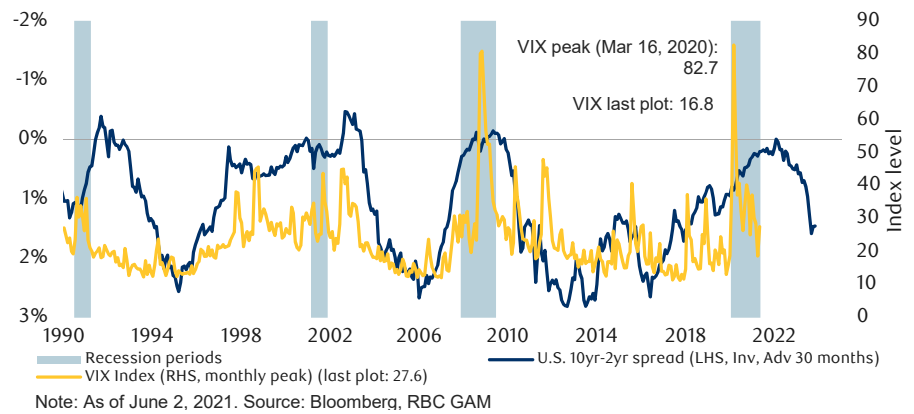
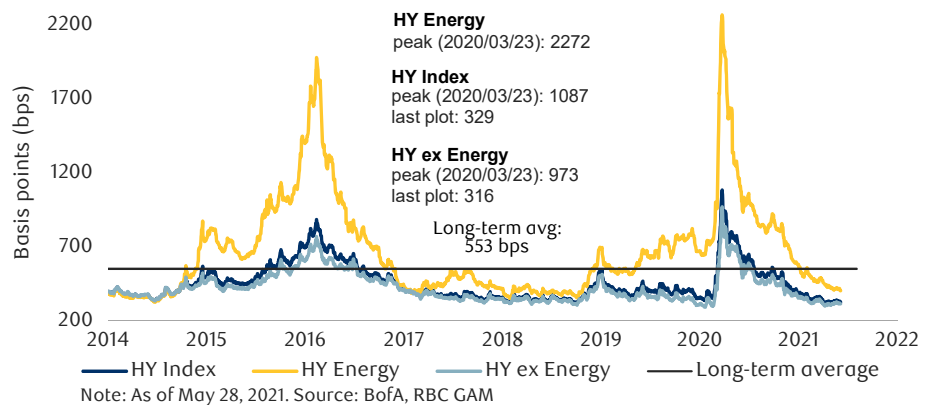


Exhibit 5: ICE BofA U.S. High Yield Index Government option-adjusted spread



that structural pressures related to technology and demographics are likely to contain inflation pressures over the longer term. However, further significant increases in inflation expectations could raise concern and affect our view of central-bank policy.

A bit higher inflation is not necessarily bad for stocks, but the threat of a sustained surge cannot be ignored. Exhibit 7 below plots average 1-year returns dating back to the 1930s for the S&P 500 segmented by various levels of inflation. Notice from the chart that stocks tend to deliver poor returns in periods of extremely low inflation (i.e. deflation) as well as extremely high inflation (above 5.5% or so), but returns were quite good in between the two extremes. Equity markets tend to treat low to moderate levels of inflation as goldilocks scenarios – not too hot and not too cold. Inflation is approaching the upper range of what appears tolerable for financial markets, but if we are right in our view, inflation will subside to more moderate levels, and likely within the current year as base comparisons moderate and supply disruptions ease.

Central banks maintain accommodative stance

Another major reason risk assets have performed so well is that financial conditions remain extremely accommodative and central banks don't seem keen on reversing this stance any time soon. The Federal Open Market Committee projects its first rate increase sometime in 2023, while the futures market is pricing in a potential hike late in 2022 (Exhibit 8). Both these projections are sufficiently beyond our forecast horizon that we don't expect any rate hikes over

Exhibit 6: Implied long-term inflation premium
Breakeven inflation rate: nominal vs 10-year real-return bond

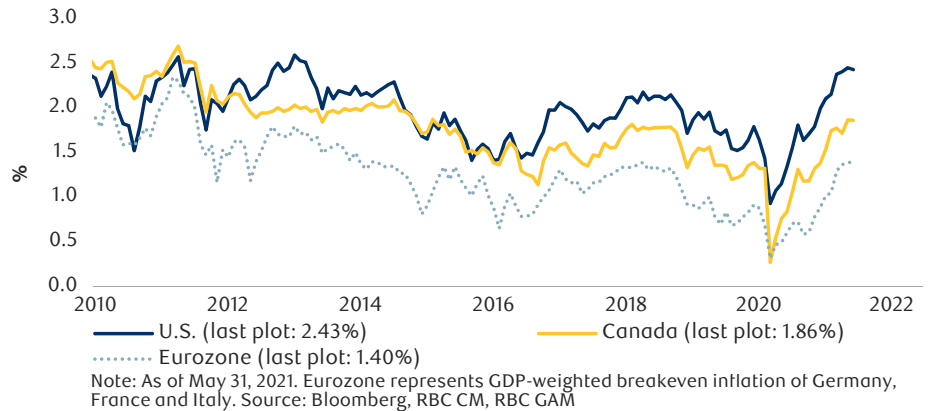


Exhibit 7: S&P 500 performance and inflation backdrop
Average of 1-year trailing returns

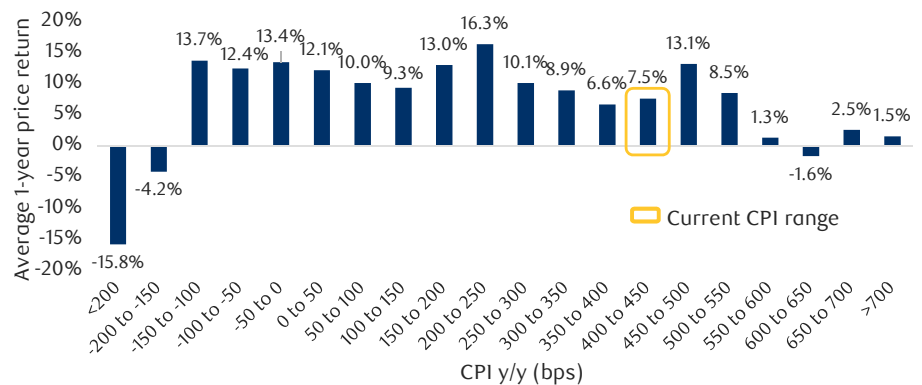
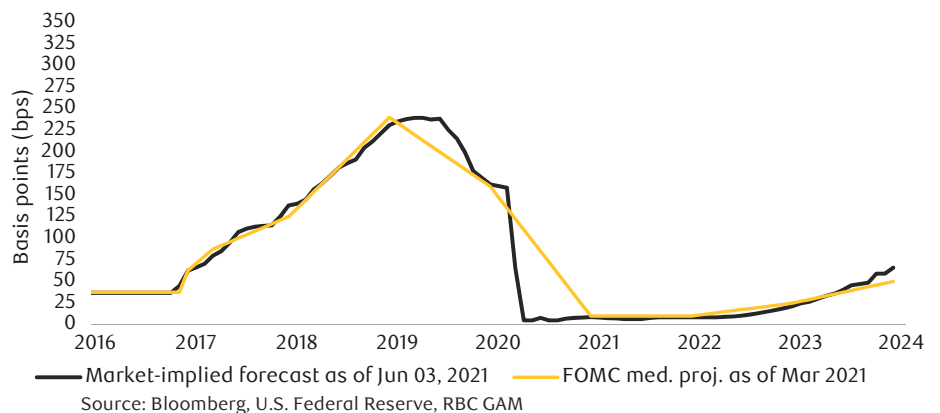


Exhibit 8: Implied fed funds rate
12-month futures contracts



the next 12 months. The Taylor Rule suggests that a slightly higher rate may be appropriate based on current and expected growth and inflation (Exhibit 9), but the U.S. Federal Reserve's (Fed) new average inflation-targeting framework means the Fed will tolerate inflation above its 2.0% target to make up for the time it spent below that level. The fact that the Fed seems intent on providing highly stimulative monetary policy offers additional support for a risk-on view.

Bond yields steady after massive increase

Much of the good news related to vaccines, a reopening of economies and firming inflation was priced into the bond market in late 2020 and early 2021 and so there was little impetus for further yield increases in the past quarter. Bond yields everywhere were range-bound over the past three months after having reclaimed their pre-pandemic levels earlier in the year (Exhibit 10). According to our models, the acute valuation risk that was apparent in the sovereign-bond market immediately following the pandemic's declaration was greatly alleviated by the rapid rise in yields over the past year (Page 38).

In the U.S., yields climbed back to within our equilibrium band over the past six months due to a combination of higher inflation and recovering real rates of interest. Exhibit 11 illustrates the construction of our 10-year Treasury model, which combines an inflation premium with a real yield to generate an equilibrium level for nominal yields. While short-term inflation has spiked, we expect that it will fall back toward a long-run sustainable level of around 2%. Real

Exhibit 9: Koenig Taylor rule and fed funds rate

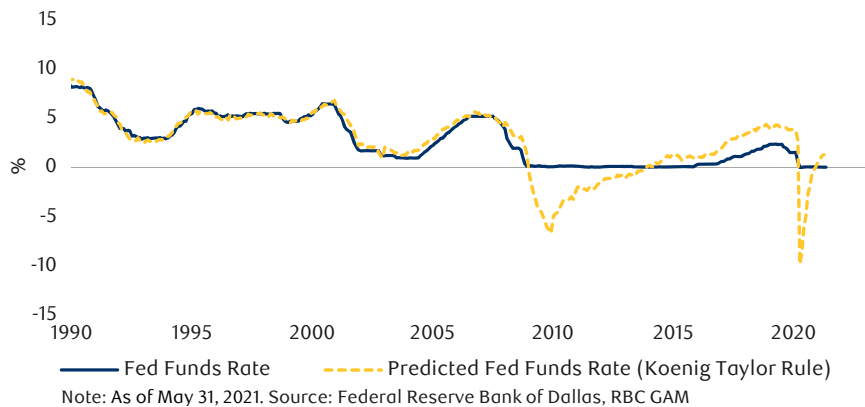
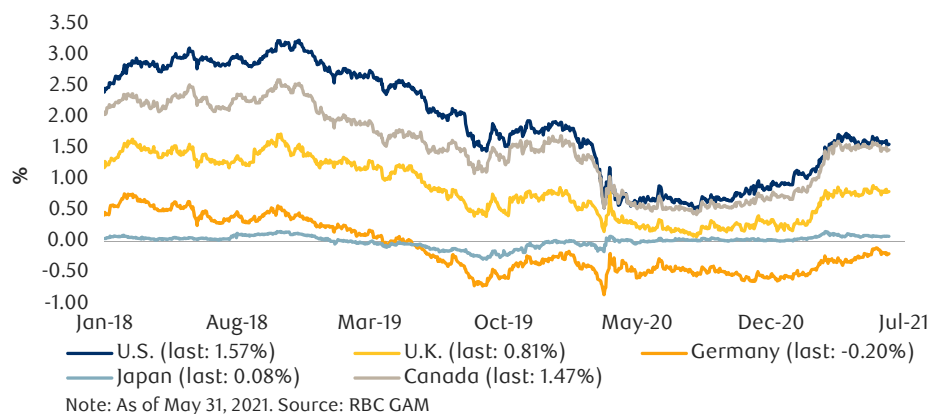


Exhibit 10: 10-year government-bond yields



rates could continue to climb from their current negative levels, but we think they will ultimately settle between 0% and 1% over the next several years as structural factors related to demographics, the maturing of emerging economies and an increased preference for saving versus spending continue to exert a powerful dampening force on real rates. Once the impact of the pandemic fades, we could be left with a 0% to 1% real rate and a 2% inflation premium. If these assumptions prove correct, it would be difficult for 10-year Treasury yields to rise much above 2% to 3% over the medium to

longer term. In the shorter term, we see yields peaking around 1.75% over the next year and, as a result, we expect low returns in sovereign bonds over the next 12 months.

Stocks rise to new highs; stretched valuations are predominantly a U.S. feature.

Global equities extended their gains in the past quarter with most major indexes reaching record levels. The S&P 500 returned 10.7% over the three-month period ended May 31, 2021, helped by strong corporate profit growth and a weakening U.S. dollar.

Canada's cyclically sensitive TSX composite outperformed, with a return of 16.0% in U.S.-dollar terms propelled by the Financials, Materials and Energy sectors. The solid rally in stocks over the past year has pushed our global GDP-weighted composite of equity-market valuations to its highest level since before the 2008/2009 financial crisis (Exhibit 12). But valuations began the past decade at about 50% below our modelled fair value, setting up conditions for very strong returns. At current levels, valuations no longer offer a significant tailwind to returns. Nevertheless, we note that the current above-average valuation in stocks largely reflects the dominance of U.S. markets, and that some markets still offer attractive discounts to fair value (Page 39). These include the United Kingdom, Japan and Europe.

Investors are paying up for significant corporate profit growth

While the S&P 500 may currently appear overvalued, it could grow into those elevated valuations fairly quickly as higher volumes and better pricing power in a strong economic recovery lift revenues and earnings. The close relationship between nominal GDP growth and revenues and profits suggests that sales could jump by double digits in each of the next two years and profits could rise close to 30% in 2021 (exhibits 13 and 14) if our growth forecasts for the economy are met. The market is excited about this extraordinary growth environment and, in our view, the S&P 500 merits a rich premium because corporate profits are surging and are expected to continue to grow rapidly for perhaps several years.

Exhibit 11: U.S. 10-year bond yield
Fair-value estimate composition

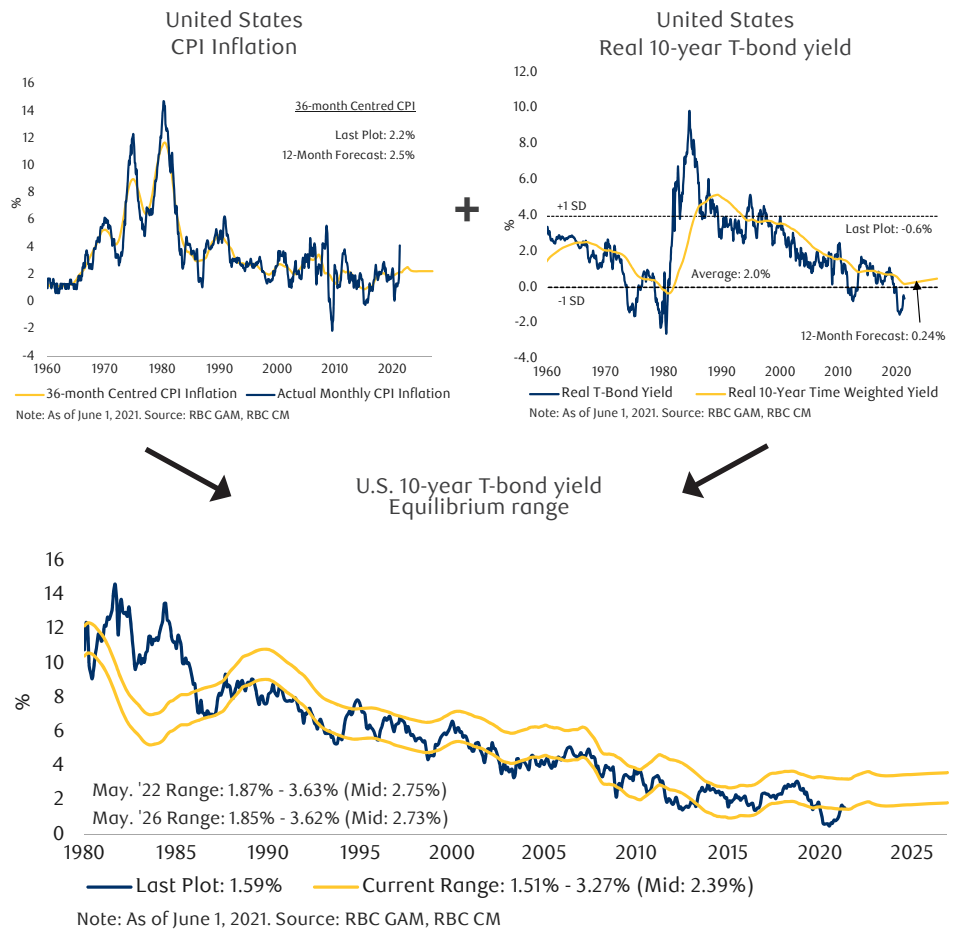


Exhibit 12: Global stock-market composite
Equity-market indexes relative to equilibrium

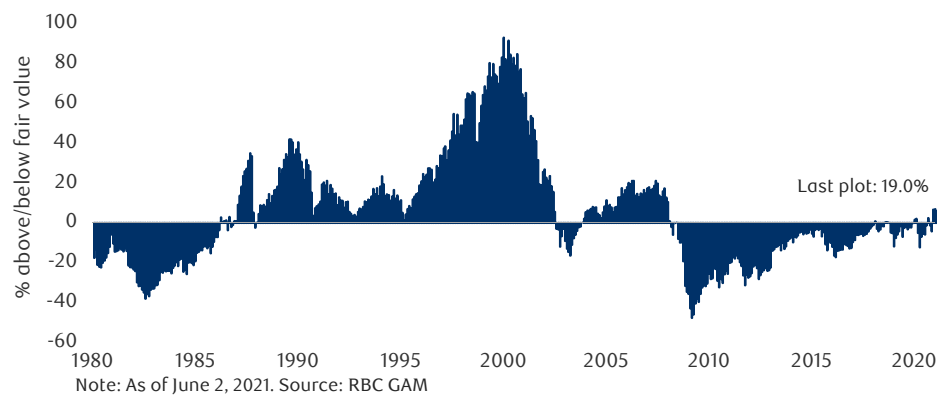


Exhibit 13: United States S&P 500 revenue and nominal GDP

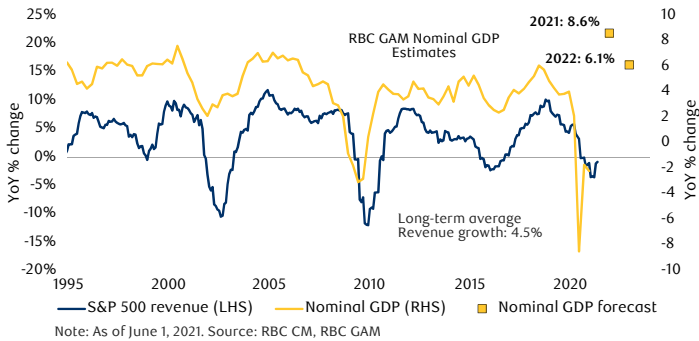
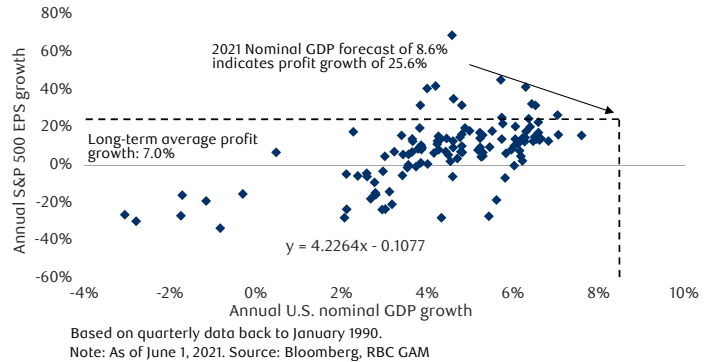


Exhibit 14: S&P 500 EPS vs U.S. nominal GDP growth



Analysts are quickly picking up on the fact that earnings are rebounding very quickly and are raising their estimates. In the second quarter, earnings exceeded expectations in 87% of company reports, the highest incidence of earnings beats in the past two decades and well above the historical average of 69% (Exhibit 15). In this environment of extremely strong growth and better-than-expected outcomes, analyst estimates have been broadly increased and consensus forecasts for S&P 500 earnings per share have risen nearly 10% since the start of the year (exhibits 16 and 17).

Exhibit 15: Companies reporting results above consensus forecasts

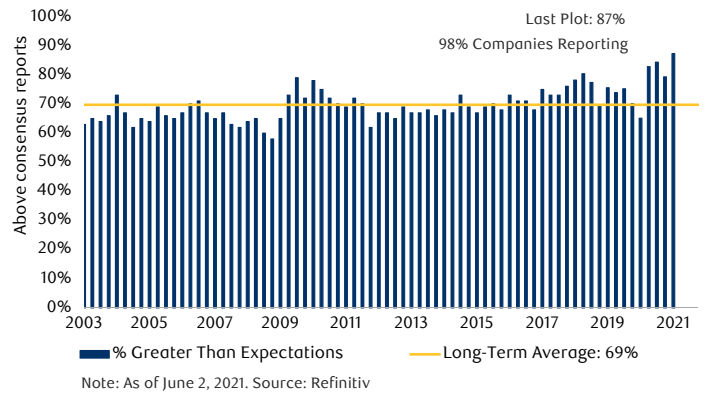


Exhibit 16: U.S. equities Companies with upward earnings revisions

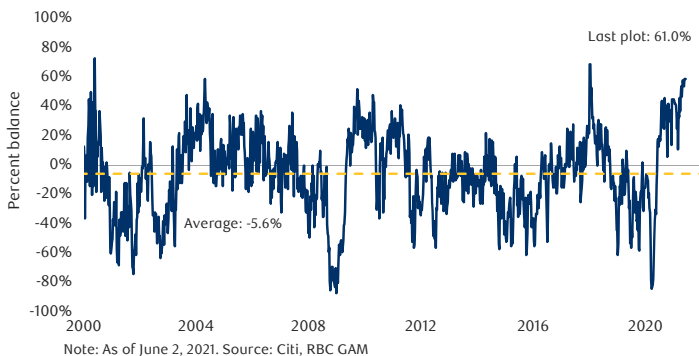
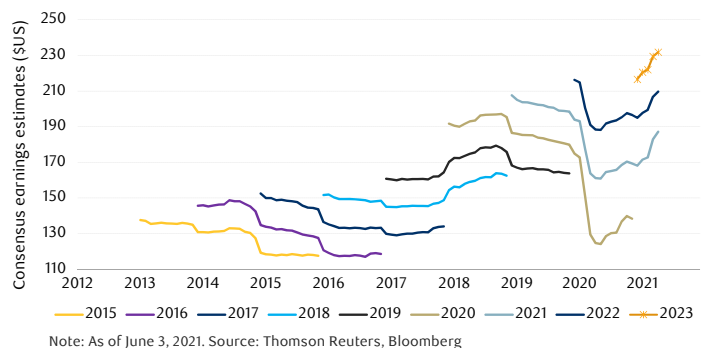


Exhibit 17: S&P 500 Index Consensus earnings estimates



Historical earnings cycles suggest more upside is possible

A look at past earnings trends reveals that the current cycle could still have much further to run. The earnings cycle is still early with profits below their prior peak and their long-term trend line (Exhibit 18). Normally profit cycles end with earnings recovering at least back to their upward sloping trend, or even above prior to a peak. Based on the past nine earnings cycles since 1958, advances on average lasted 5.4 years and peaked 64% above their prior high (Exhibit 19). The current cycle is less than one year old and profits remain 7% below their pre-pandemic peak, so the potential exists for a durable and meaningful increase in profits ahead even if the current cycle proves relatively mild.

Scenario analysis reveals attractive return potential if valuations remain above equilibrium

Our scenario analysis suggests that in order for stocks to deliver compelling returns, valuations will need to remain above our modelled equilibrium level. Our models suggest a neutral multiple on 12-month trailing earnings for the S&P 500 right now is 18x, which is the level consistent with current and historical interest rates, inflation and corporate profitability. Exhibit 20 outlines a wide range of outcomes for the S&P 500 through 2023 based on combinations of earnings and a variety of P/E ratios. Should the S&P 500 earn \$209.70 per share in 2022 and trade at an equilibrium P/E of 18.0x, the index

Exhibit 18: S&P 500 earnings comparison

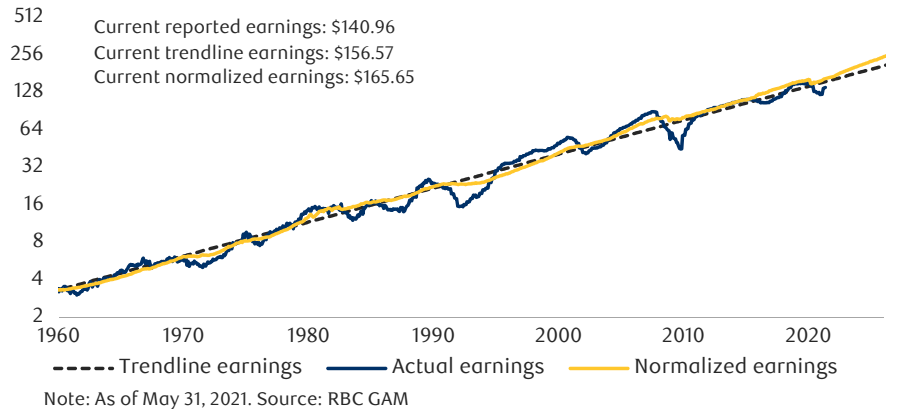


Exhibit 19: US: history of earnings through cyclical expansions

Earnings trough	Earnings peak	Length of cycle (years)	Inflationary environment	Earnings % increase trough-peak	S&P 500 % change during cycle	Earnings % increase from previous peak
Sep-58	Sep-59	1.0		13%	14%	
Jun-61	Sep-69	8.3		88%	44%	71%
Dec-70	Sep-74	3.8	High	50%	-31%	45%
Sep-75	Mar-80	4.5	High	83%	22%	73%
Dec-80	Dec-81	1.0	High	1%	-10%	6%
Jul-83	Jun-89	5.9		101%	96%	60%
Jan-92	Oct-00	8.8		258%	250%	129%
Apr-02	Jul-07	5.3		115%	35%	61%
Oct-09	Aug-19	9.8		236%	182%	69%
Dec-20	May-21?	0.4		14%	12%	-7%
Average		5.4		86%	67%	64%
Median		5.3		88%	35%	65%
Standard deviation		3.2		89%	93%	34%

Note: High inflationary environment defined as inflation exceeding 3.6%

would trade at 3772 by the end of next year, representing a 10% decline from the current level. Looking to 2023, the index earnings estimate of \$231.80 combined with a P/E of 18.0x yields a S&P 500 reading of 4170, in line with the current level. While these numbers are not exactly appealing, they suggest the market is not outrageously ahead of itself and, should confidence wane, stocks could be supported not far below current levels. Nevertheless, we think that the P/E could trade at half or even a full standard deviation above equilibrium in an environment of low interest rates and limited alternatives for investors. A market multiple of 20.1x trailing index earnings of \$231.80 by 2023 would situate the index at 4664 and generate a total return of about 5.8% annualized from now until the end of 2023. Our conclusion is that U.S. stocks could offer decent returns in the mid to high single digits as long as investor confidence holds up and earnings come through.

Investment styles confirm positive outlook

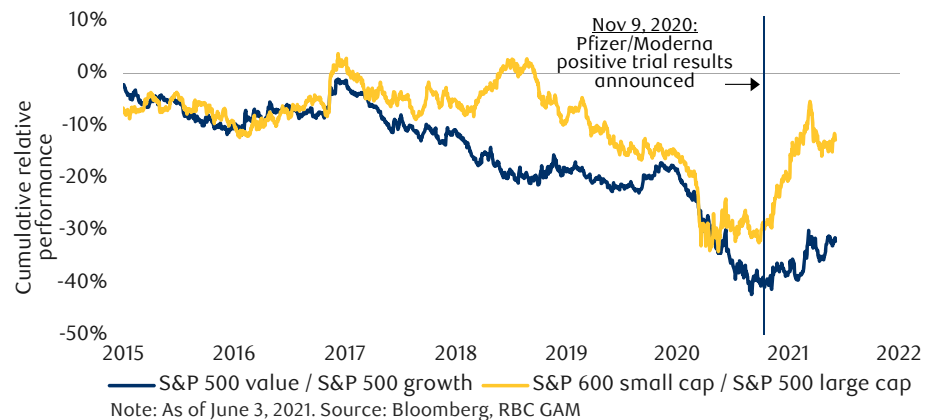
The market has undergone a significant style shift since the announcement of a successful vaccine-trial result in November 2020 stoked confidence that the virus could be overcome. Investors have rotated into small-cap and value stocks, which tend to be more sensitive to changes in economic growth. The S&P 600 Small Cap Index has outperformed its large-cap counterpart by 33% since early November, and the S&P 500 Value Index gained 15% versus the S&P 500 Growth Index over the same period (Exhibit 21). While both styles are below their recent relative highs, they have remained in an upward trend

Exhibit 20: Earnings estimates and alternative scenarios for valuations and outcomes for the S&P 500 Index

		Consensus		
		2021 Bottom up	2022 Bottom up	2023 Bottom up
	P/E	\$187.1	\$209.7	\$231.8
+1 Standard Deviation	22.3	4164.3	4666.3	5157.9
+0.5 Standard Deviation	20.1	3765.3	4219.3	4663.7
Equilibrium	18.0	3366.3	3772.2	4169.6
-0.5 Standard Deviation	15.9	2967.4	3325.1	3675.4
-1 Standard Deviation	13.7	2568.4	2878.0	3181.2

Note: as of June 1, 2021. Source: Bloomberg, Thomson Reuters, RBC GAM

Exhibit 21: Relative style performance



since their late 2020 lows, suggesting the economy continues to improve.

Asset mix – maintaining overweight stocks, underweight bonds

The economic recovery is enjoying the cyclical tailwinds of massive monetary and fiscal stimulus, an easing of virus-related restrictions and low interest rates. We expect very strong economic growth in 2021 and above-average growth next year as the economy accelerates at a rate that supports strong corporate-profit gains. Inflation

is firming but we don't think it will rise to and remain at problematic levels. Ultimately, our view is that the rate of price increases will trend toward its long-term norm. Against this backdrop, we feel a bias towards risk-taking is appropriate.

Structural forces are worth keeping in mind when determining a proper asset mix. Massive changes in demographics and slowing growth rates for the emerging world will likely hold down real rates of interest and reduce the return potential for all asset classes

over the coming decades. In fact, a reliable way to forecast 10-year returns on bonds is to look at the current yield to maturity, which suggests low single-digit returns in sovereign bonds (Exhibit 22). For stocks, Shiller's Cyclically Adjusted P/E (CAPE) has also been a credible forecasting tool and indicates somewhat below-average returns for U.S. equities in particular over the next decade, but much above those for bonds (Exhibit 23).

We think a meaningful overweight in equities is suitable. Recall that ultra-low long-term return expectations for fixed income motivated our decision over a year ago to boost the strategic neutral weight in stocks to 60% from 55%. Investors with long-term savings plans, in our view, would likely want to minimize exposure to sovereign bonds and boost equity allocations. That said, the powerful advance of U.S. equities over the past year prompts us to recognize that their valuations are full and that the risk premium between stocks and bonds has narrowed somewhat. We have therefore made a small cut of 50 basis points to our equity overweight versus last quarter, sourced entirely from U.S. equities, and moved the proceeds to bonds. For a balanced, global investor, we currently recommend an asset mix of 64 percent equities (strategic neutral position: 60 percent) and 35 percent fixed income (strategic neutral position: 38 percent), with the balance in cash.

Exhibit 22: U.S. 10-year Treasury note and returns

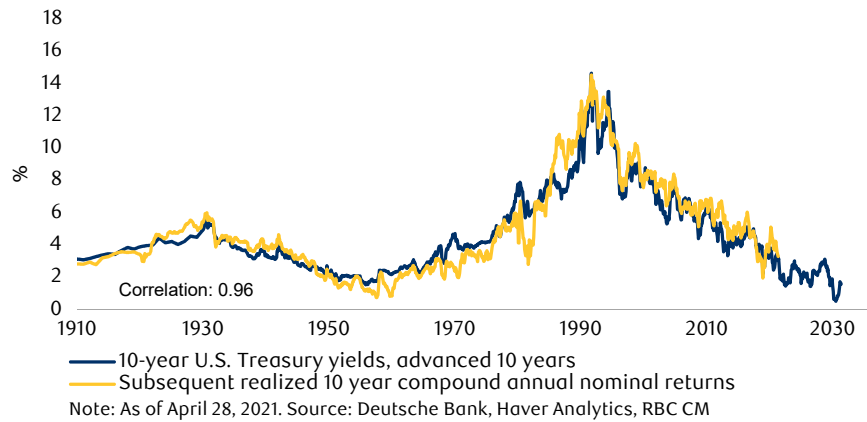
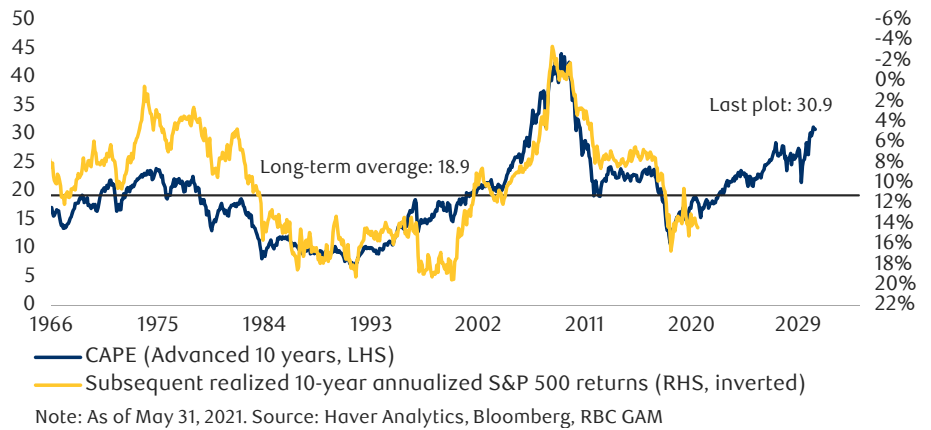
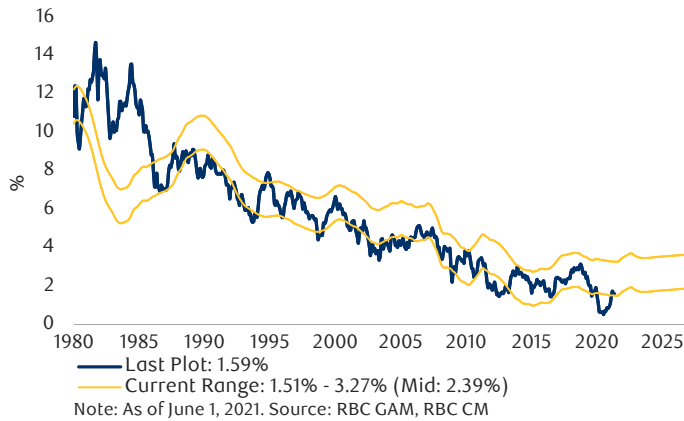


Exhibit 23: Shiller's CAPE
Real S&P 500 Index / 10-year average of real EPS

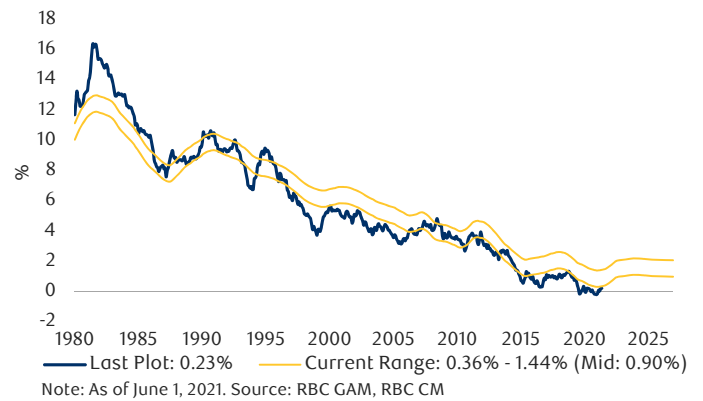


Global Fixed Income Markets

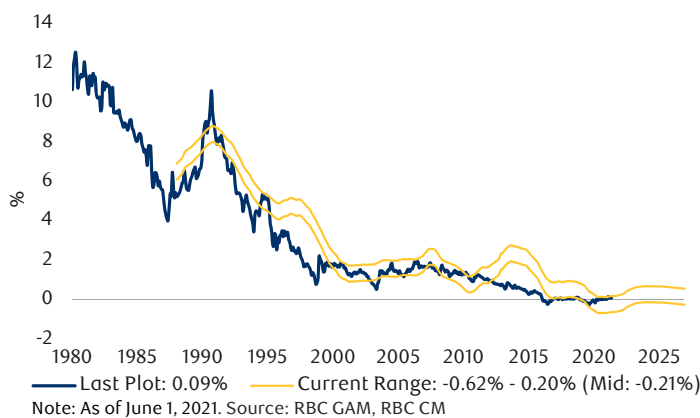
U.S. 10-Year T-Bond Yield
Equilibrium range



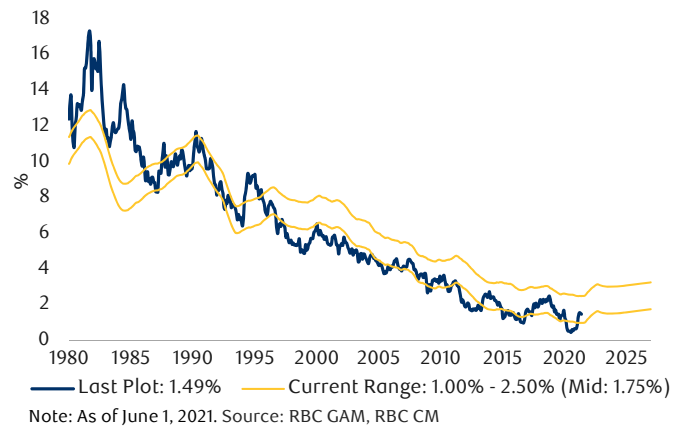
Eurozone 10-Year Bond Yield
Equilibrium range



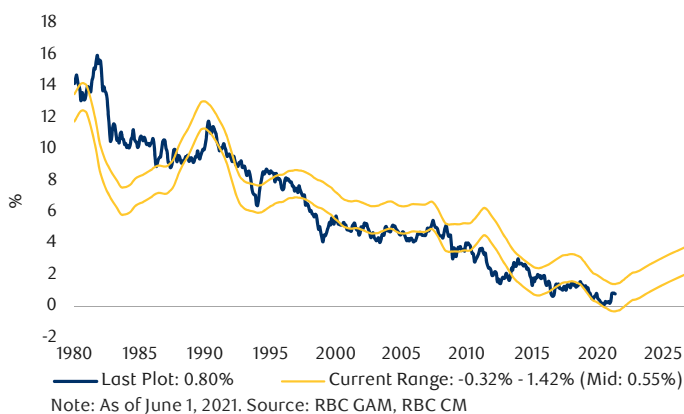
Japan 10-Year Bond Yield
Equilibrium range



Canada 10-Year Bond Yield
Equilibrium range



U.K. 10-Year Gilt
Equilibrium range

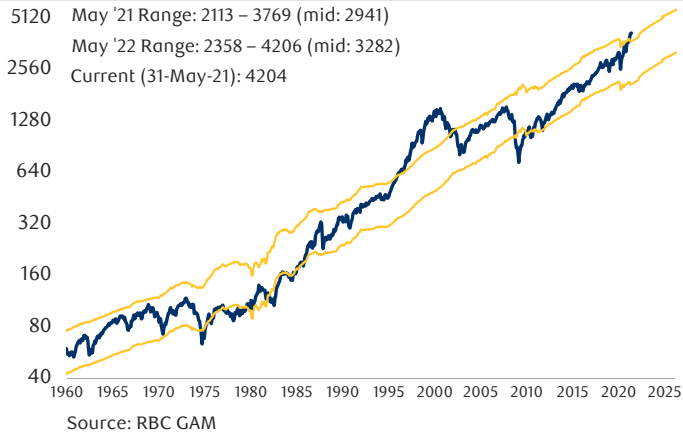


“ According to our models, the acute valuation risk that was introduced into the sovereign-bond market immediately following the pandemic’s declaration was greatly alleviated by the rapid rise in yields over the past year. ”

Global Equity Markets

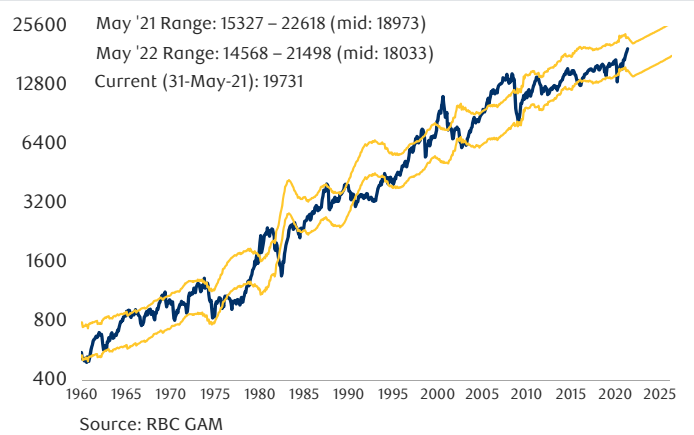
S&P 500 Equilibrium

Normalized earnings and valuations



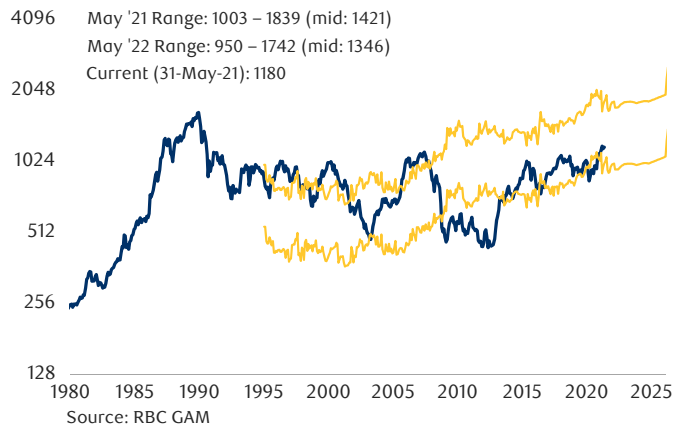
S&P/TSX Composite Equilibrium

Normalized earnings and valuations



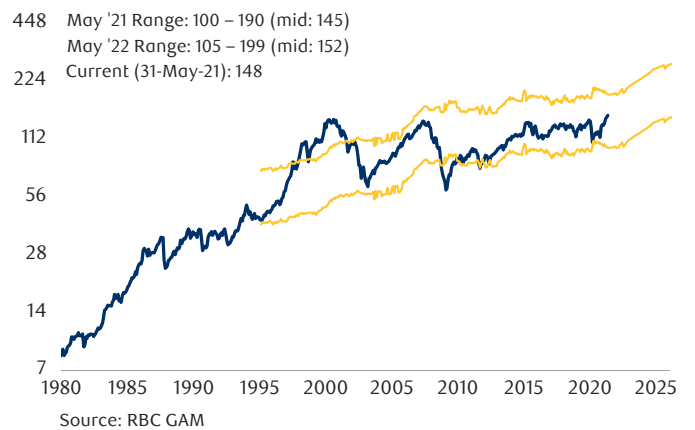
MSCI Japan Index

Normalized earnings and valuations



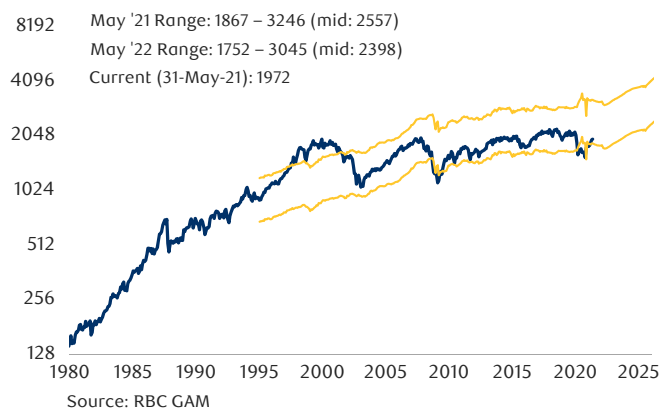
MSCI Europe Index

Normalized earnings and valuations



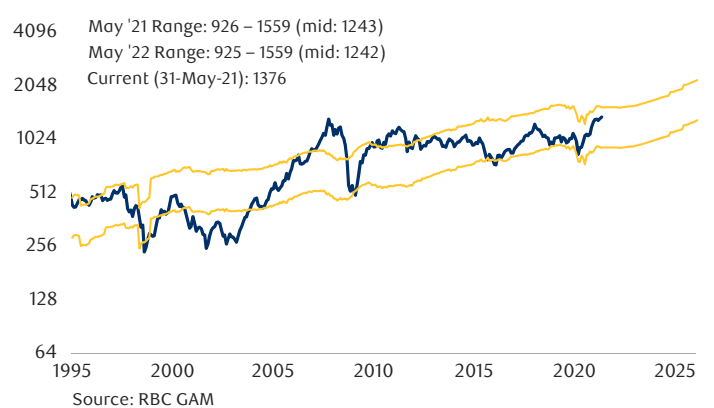
MSCI U.K. Index

Normalized earnings and valuations



MSCI Emerging Markets Index

Normalized earnings and valuations



Global Fixed Income Markets

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Government-bond yields were largely unchanged over the past three months, and, while still on the low side, are within our fair-value range. Over the next 12 months we expect yields to rise, but at a much slower pace than they did in early 2021. Economic growth and inflation are likely to peak sometime during the summer, relieving much of the pressure on bond prices. Our 12-month forecast for the U.S. 10-year Treasury yield is 1.75%.

As the darkest days of the pandemic recede, inflation readings at their highest in a decade are emerging as a major worry for bondholders. U.S. consumer prices rose 4.2% in April from a year earlier, the fastest pace since 2008 (Exhibit 1), while the increase in Canada was 3.4%, the most since 2011. We believe inflation was higher still in May, and that this period of more significant inflation could persist through the middle of the year. Asset prices are also climbing, with housing prices gaining nearly 25% in most developed markets. We believe, however, that a lasting return to much stronger inflation is unlikely and this view is reflected in our forecasts for bond yields. A more aggressive pickup in inflation would likely send yields much higher than we expect.

Is higher inflation a harbinger of persistently stronger price pressures to come? While inflation will in all probability remain above 2% for most of 2021, price increases are likely to subside after we get past the next few months. Eventually, we expect inflation to fall back to central bankers' targets near 2%, and perhaps even below that. Central bankers have struggled for years to generate meaningful inflation, and while the pandemic was a historic shock to industrial supply chains and workers, it has failed to unseat any of the long-run structural forces pushing down on prices. These forces include aging populations, technological innovation, rising wealth and income inequality, and the increased power of corporations to set wages.

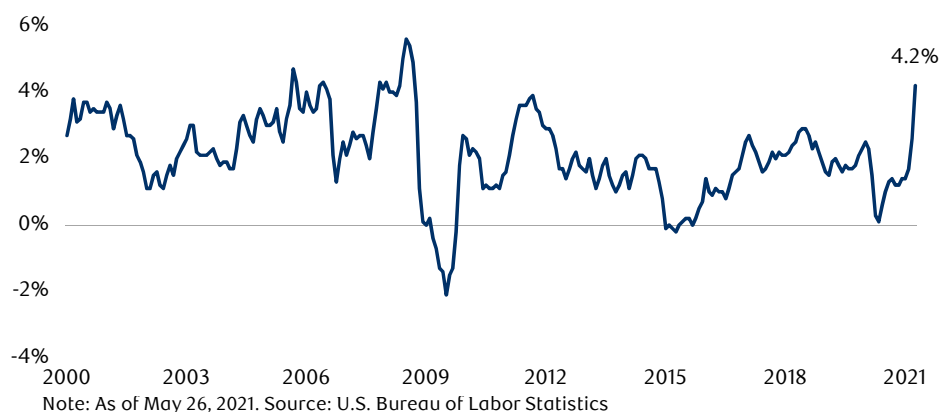
We also believe that the initial burst of inflation caused by the pandemic is likely to be followed by deflationary pressures. These include a higher labour-participation rate, as the option to work from home gives more people access to jobs, an accelerated transition to online shopping, where

prices tend to be lower than in physical stores, and a higher savings rate as the psychological impact of the pandemic increases the desire of households to hold larger rainy-day funds.

That said, we are not totally out of the woods on inflation. The economy is opening up unevenly, as consumers spend relatively freely on goods while activity in service industries remains constrained because these businesses often require close contact. As a result, money normally earmarked for spending at restaurants and hair salons and on vacations has been funneled into electronics and home improvements. At the same time, corporate supply chains are struggling to keep up with demand, and much of the current inflation revolves around goods makers passing on the rising costs via higher prices.

Meanwhile, consumer demand has been supported by a massive ramping-up of pandemic-related government spending financed by bond sales. Government deficits around the world

Exhibit 1: U.S. inflation highest since 2008
U.S. Consumer Price Index, year-over-year change



are the highest they have ever been outside of wartime and show few signs of being curtailed. The extension of explosive government spending and historically low interest rates just as the worst economic effects of the pandemic fade is generating fear that governments are using the pandemic to add permanent fiscal programs rather than simply offset COVID-related losses.

The final ingredient in this fear-of-inflation recipe is the current cadre of central bankers, all of whom came of age during the past several decades of falling inflation and who appear to be more permissive of inflation than any group since the 1960s. There is a well-founded concern that this set of policymakers would prefer to let inflation run hot rather than tap the brakes on an economic recovery.

Post-recession fears about inflation, especially after large government-stimulus programs, have ample precedent. Inflation surged to 4% as the economy began to recover from the 2008-2009 financial crisis, and then cooled as the cyclical effects of the economic rebound faded and long-term structural factors re-asserted themselves. This is likely to be the case this time around. As demand for goods eases and services return in force, the inflationary impact of consumers' unbalanced spending will likely pass.

Most central bankers view the current rise in inflation as likely to be transitory. As a result, they will focus on the damage caused by the pandemic to labour markets, particularly lower-income households whose members are typically employed in service industries. Central

banks will therefore be unlikely to start raising interest rates until the labour-market recovery is advanced. Emergency government programs have helped alleviate the worst of the economic effects of the crisis but they must eventually end. The recovery from the pandemic for these households, unlike the recovery in the stock market, is likely to be slow. We note that it took the labour market the better part of a decade to recover the jobs lost during the financial crisis.

Bond yields are likely to push higher only when the labour-market recovery is more firmly established and investors anticipate that central banks are getting closer to rate hikes. But these conditions are a long way off in our view. Fixed-income markets are pricing in a return to pre-pandemic policy rates that overstate the case for persistently high inflation and overlook just how much lingering damage COVID-19 is likely to have inflicted on labour markets.

Direction of interest rates

U.S. – Inflation moved to its highest point in over a decade in April at 4.2%, and is likely to remain high for the next few months as pandemic-related effects work their way through the year-on-year numbers and supply bottlenecks remain tight. For now, we don't expect inflation to become so high that it concerns the U.S. Federal Reserve (Fed). The labour-market recovery in the U.S. is still in the early stages and the Fed is likely to consider any high inflation as transitory. Market indicators suggest that the first rate hike will occur in late 2022 or early 2023.

We forecast no change in the fed funds rate over the next 12 months. It is more likely, in our opinion, that the next rate hike will come sometime in 2023 rather than in 2022. Well before the first rate hike, the Fed will move to slow its asset-purchase program, a multi-step process that will take some time. We are forecasting the 10-year Treasury to be around 1.75% within the next 12 months. Treasury yields are likely to be range-bound for the rest of the year as the post-pandemic bump in growth and inflation is expected to cool.

Canada – Bank of Canada (BOC) policymakers struck a tone that made investors think they might scale back monetary stimulus sooner than expected, even as they have committed to holding their benchmark interest rate as low as they reasonably can. In the BOC's view, the 2% inflation target will be sustainably achieved by the second half of 2022 instead of sometime in 2023. As expected, the central bank also reduced the pace of bond buying to \$3 billion per week from \$4 billion, and we expect that figure to decline to \$2 billion within the next six months. The BOC's decision to rein in asset purchases contrasts with the Fed, which deems it too early to even discuss the possibility of reduced bond purchases. The reduction in asset purchases was driven by concerns that Canada's central bank owns too much of the country's bond market.

April marked the release of the first federal fiscal budget since 2019, and bond-issuance forecasts were in line with investor expectations of \$286 billion for the current fiscal year, a decrease from the previous year's \$374 billion. The government plans to

devote a larger share of its issuance to longer-maturity bonds, which we believe could limit their performance. According to the budget's forecasts, bonds with maturities of 10 years or longer will comprise 42% of issuance in the current fiscal year, up from 29% last year and 19% two years ago.

Canadian bond yields have stabilized after doubling in the first quarter of 2021, and we expect bond yields to trade in a range that prices in strong economic growth, higher inflation and increased government-bond issuance. Investors have priced in roughly 40 to 50 basis points of tightening by the end of 2022, in line with current BOC guidance and our expectations. Over the next 12 months we expect no change to the BOC's overnight rate, currently at 25 basis points, and forecast that the yield on the 10-year government bond will reach 1.60%.

Japan – The Bank of Japan (BOJ) made no policy changes over the past quarter, and we expect that to be the case over the next 12 months. The policy rate, at -0.10%, is unlikely to be changed without a more fundamental re-evaluation of the central bank's policy framework, and the BOJ just completed a thorough policy review. Based on the outcome of the review, we have marginally increased the odds of a more negative policy rate. At this point in the cycle, however, it is unlikely absent another meaningful downturn in activity. Meanwhile, this summer's Tokyo Olympics should provide a nice fillip for the economy, and we expect some steepening of the Japanese yield curve. Over the long term, the likelihood of higher bond yields is low given persistently weak inflation and

Interest rate forecast: 12-month horizon

Total Return calculation: May 26, 2021 – May 27, 2022

U.S.						Horizon return (local)
	3-month	2-year	5-year	10-year	30-year	
Base	0.13%	0.30%	1.00%	1.75%	2.40%	0.60%
Change to prev. quarter	0.00%	(0.10%)	0.30%	0.45%	0.40%	
High	0.25%	0.90%	1.50%	2.25%	2.80%	(2.21%)
Low	0.13%	0.13%	0.00%	1.00%	1.50%	6.35%
Expected Total Return US\$ hedged: 0.89%						

Germany						Horizon return (local)
	3-month	2-year	5-year	10-year	30-year	
Base	(0.50%)	(0.50%)	(0.50%)	(0.25%)	0.30%	(0.23%)
Change to prev. quarter	0.00%	0.00%	0.00%	0.10%	0.40%	
High	(0.50%)	(0.25%)	(0.20%)	0.00%	0.35%	(1.55%)
Low	(0.50%)	(0.60%)	(0.75%)	(0.75%)	(0.35%)	7.51%
Expected Total Return US\$ hedged: 1.17%						

Japan						Horizon return (local)
	3-month	2-year	5-year	10-year	30-year	
Base	(0.10%)	(0.10%)	(0.05%)	0.10%	0.65%	0.52%
Change to prev. quarter	0.00%	0.00%	0.00%	0.05%	0.00%	
High	(0.10%)	(0.05%)	0.00%	0.25%	0.85%	(2.46%)
Low	(0.10%)	(0.10%)	(0.10%)	(0.10%)	0.40%	4.48%
Expected Total Return US\$ hedged: 0.85%						

Canada						Horizon return (local)
	3-month	2-year	5-year	10-year	30-year	
Base	0.25%	0.50%	1.00%	1.50%	2.00%	2.07%
Change to prev. quarter	0.00%	0.00%	0.25%	0.40%	0.40%	
High	0.38%	0.75%	1.50%	2.00%	2.40%	(1.52%)
Low	0.15%	0.15%	0.50%	1.00%	1.50%	6.64%
Expected Total Return US\$ hedged: 1.83%						

U.K.						Horizon return (local)
	3-month	2-year	5-year	10-year	30-year	
Base	0.10%	0.20%	0.40%	0.70%	1.30%	1.00%
Change to prev. quarter	0.00%	0.00%	0.15%	0.40%	0.50%	
High	0.10%	0.40%	0.75%	1.10%	1.40%	(1.19%)
Low	0.10%	0.10%	0.10%	0.25%	0.60%	12.33%
Expected Total Return US\$ hedged: 2.04%						

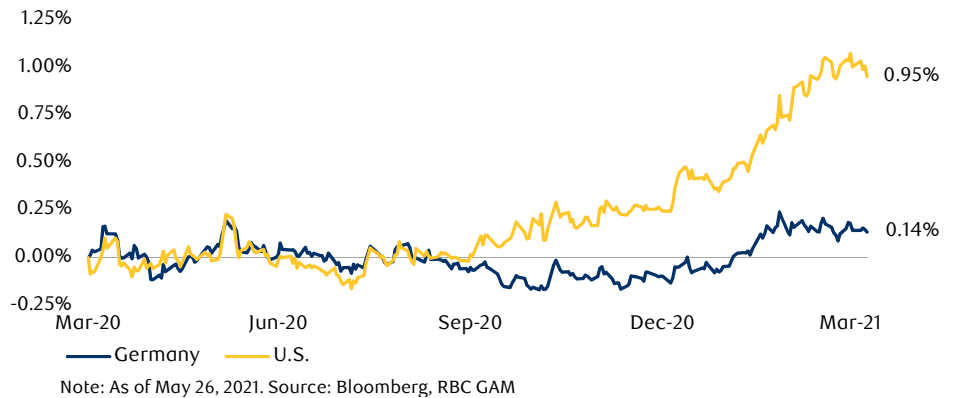
Source: RBC GAM

an aging and shrinking population. Our 12-month forecast for the yield on 10-year Japanese government bonds is 0.10%, an increase of 5 basis points from our forecast last quarter.

U.K. – The U.K. has emerged as a leader in getting its people vaccinated, and its economy is opening up at the same time that the ruling Conservative government, long a preacher of fiscal probity and austerity, has chosen to instead turn on the fiscal taps. The fiscal expansion and the pandemic are masking some of the disruptions lurking after the country officially left the European Union at the end of 2020. Nevertheless, the U.K. economy is doing reasonably well given the circumstances, and gilt yields have been heading higher. We expect the Bank of England to be on hold for at least 12 months, by which time it should be clear whether the global economy has turned the corner. We forecast the yield on the 10-year government bond at 0.70% within the next 12 months.

Eurozone – The vaccination rollout in most of the eurozone has lagged that in other developed markets, with the effect being to dampen economic activity as the euro-area

Exhibit 2: U.S. yields have risen much more than German yields
Change in U.S. and German government-bond yields since March 2020



economy unexpectedly contracted over the first three months of the year. Inflation pressures in the eurozone are relatively muted compared with the U.S., leading investors to the conclusion that rate hikes will be later in arriving and be more modest when they do. The European Central Bank's (ECB) asset-purchase programs remain particularly important for holding down yields on euro-denominated sovereign and corporate bonds. We expect that these programs will continue until at least the end of this year. Perhaps reflecting the relative weakness of its economic recovery, the ECB has been much more aggressive than its U.S. counterpart in keeping a

lid on borrowing costs. As an example, the ECB has raised its asset-purchase pace in response to higher real yields, and this step partly explains why German yields have risen less than U.S. Treasury yields over the past year (Exhibit 2). We expect the ECB to leave its overnight policy rate unchanged over the next 12 months and for the German 10-year bund yield to be -0.25% in a year's time.

Regional recommendations

We are overweight European sovereign bonds versus Japanese government bonds, reflecting the former's better potential for capital appreciation on a currency-hedged basis.

Currency Markets

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

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RBC Global Asset Management Inc.

Daniel Mitchell, CFA

Portfolio Manager
RBC Global Asset Management Inc.

After a year in which the U.S. dollar lost more than 10% of its value, the No. 1 question facing investors is whether the dollar is on the verge of a rebound that reflects a U.S. recovery, successful vaccination programs and an economic reopening. Our answer remains that the U.S. dollar has further to fall as the greenback's multi-year decline is still in its early stages and longer-term drivers continue to weigh on the currency. We believe that the dollar is in the first half of a broad-based bear market, and we are particularly positive on cyclical currencies that will benefit most from the reopening.

Given the threat of inflation and uncertainty about the timing of the U.S. Federal Reserve's (Fed) withdrawal of exceptionally easy monetary policy, foreign-exchange traders are paying heed to the impact of bond markets on currency movements. Market participants are watching not only nominal interest rates but also real rates and term premiums. As each of these interest-rate components come to the fore at different times, a more nuanced interpretation of the bond-market fluctuations may be required. We note that last year's rise in nominal yields, which was driven mainly by inflation expectations, left the dollar weakened, while the rise of real rates

in the first quarter of 2021 gave it a boost.

The greenback's rally in the first quarter of 2021 caught many traders flat-footed. The 3% trade-weighted gain wasn't big by historical standards, but that statistic masks more meaningful appreciation in some individual currencies. The currencies of Brazil, Colombia and Japan weakened by at least 6% while the euro – the second most actively-traded currency – dropped by 5%. Traders who were betting heavily against the U.S. dollar at the end of last year were forced to cut those positions as the greenback bounced, amplifying the dollar's ascent. Economic and political developments unfolding on both sides of the Atlantic also contributed to the move. In the U.S., optimism around economic growth was largely fed by President Joe Biden's stimulus cheques and the expectation that some infrastructure spending would be unveiled this year. Abroad, it was the sluggish pace of COVID-19 vaccinations and associated lockdowns, particularly

in Europe, that made the dollar look relatively attractive. As these themes were incorporated into the dollar's value the slate was cleared by the end of March for longer-term dollar-negative factors to re-assert themselves.

We are focused on the broad trajectory of currency markets and like to make use of long-term fundamental factors to inform our outlook. On these longer-term metrics, the dollar is clearly unattractive given that U.S. budget and trade deficits are rapidly deteriorating, reserve managers are showing a preference for the Chinese currency and the dollar remains overvalued even after the recent selloff. Our work suggests that the fourth major U.S.-dollar bear market of the past five decades began in the spring of 2020 (Exhibit 1), and that several more years of weakness lie ahead (Exhibit 2). Short-term rallies in the dollar should be expected, but investors with longer investment horizons will be rewarded for sticking with a bearish stance.

Exhibit 1: Long-term cycles in the U.S. trade-weighted dollar

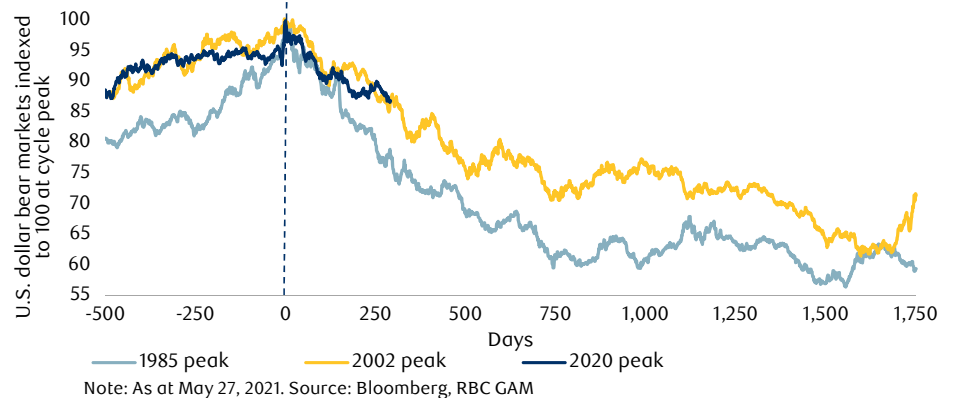


Note: As at May 28, 2021. Source: Bloomberg, RBC GAM

Those with a shorter investment horizon should consider political developments, trends in economic data, commodity prices and other indicators that tend to drive near-term exchange rates. Of late, it is bond markets and interest rates that have taken centre stage, due mostly to rising inflation and disparate central-bank policies. And yet the currency reaction has not been intuitive – the dollar actually declined as U.S. yields rose over the past 12 months. Even the greenback’s temporary rally during the first quarter of 2021 was mild compared with the steep rise in yields accompanying it.

To understand this new dynamic, we need to look beyond the level of nominal Treasury yields and instead break down that U.S. 10-year yield into its components. First, a portion of the yield represents compensation for the expected level of inflation over that 10-year horizon. You might be reluctant to make an investment if you expect its value to buy you fewer goods and services at the end of the investment’s lifetime. Another component is the “real yield” – the yield you might expect to take home once inflation has eroded the purchasing power of your capital. The U.S. dollar’s performance is much more closely linked to fluctuations in real yields than nominal yields. This makes sense: a rise in nominal yields caused by higher inflation expectations would hardly be dollar-positive because it represents a quicker erosion in the currency’s value. In contrast, rising real yields indicate increased optimism among investors for the U.S. economy and U.S. assets, bolstering the value of the greenback.

Exhibit 2: U.S. dollar bear-market roadmap



A Morgan Stanley framework that we have adapted helps us visualize how the dollar has historically performed in four environments where interest rates and inflation expectations are fluctuating (Exhibit 3). Looking back over a full U.S.-dollar cycle, we can make a few observations:

- The dollar’s performance against developed-market currencies is driven by fluctuations in real yields. Regime 1 is most negative for the greenback because it combines less interest-rate support from real yields and an increasing expectation that the dollar’s value will be eroded by inflation. This is the current environment, and one that supports our view for continued U.S.-dollar weakness.
- The dollar follows a slightly different pattern against emerging-market currencies. The rise in real yields in Regime 2, for example, tends to be less threatening for emerging-market currencies because that environment is one where economic growth is strong, commodities

are rallying and risk sentiment is positive. This would be very much in tune with our expectation for cyclical currencies to continue to outperform the U.S. dollar for a few years.

- A third observation is the tendency for the environment to shift in line with economic conditions. As economic growth continues to recover and inflation pressures build, we will likely see a shift into Regime 2 as real yields begin to rise, followed by a transition to Regime 3 as Fed interest-rate hikes temper inflation expectations. Finally, the rotation through the four regimes is completed later in the economic cycle as economic growth fades and rate cuts follow. While an eventual move into Regime 3 would prompt us to re-evaluate our view, we are comfortable that real yields remain capped for now by a laundry list of factors, including low Fed policy rates, quantitative easing and ample global liquidity.

Emerging-market currencies

The current environment is close to what one would consider the sweet spot for emerging-market currencies. A weaker dollar, healthy risk appetite and strong commodity prices all support appreciation in emerging-market currencies, as do fiscal and monetary trends. Both fiscal and monetary policy are being kept extremely accommodative in the developed world even as the world's major economies recover. Cheap loans and stimulus checks, combined with a move toward online spending have emerging-market economies experiencing a boom in exports that far outweighs any hit to tourism revenues. The resulting improvement in current-account balances (Exhibit 4) over the past year has reduced their reliance on short-term borrowing and places emerging-market countries in a better position to withstand the threat of rising Treasury yields. What's more, many emerging-market countries have been relatively conservative in their pandemic spending, have large foreign-exchange reserve buffers and have manageable levels of debt. All the while, emerging-market currencies remain undervalued (Exhibit 5). In addition to these factors, there are two others that could contribute to further emerging-market currency gains this year:

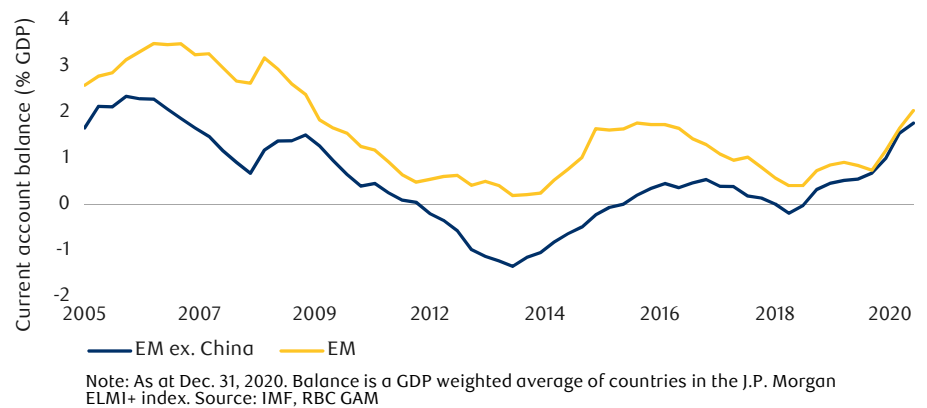
1. Authorities in several emerging markets have already tightened monetary policy or have signaled that they plan to. Central banks in Russia, Turkey (until President Erdogan's intervention) and Brazil hiked rates earlier this year and investors expect that Hungary,

Exhibit 3: Medium-term framework for the U.S. dollar

Regime		vs. G10	vs. EMFX	Commodities	U.S. equities
1	Real yields ↓	USD ▼	USD ▼	Stronger	Stronger
	Inflation expectations ↑				
2	Real yields ↑	USD ▲	USD ▼	Stronger	Stronger
	Inflation expectations ↑				
3	Real yields ↑	USD ▲	USD ▲	Weaker	Weaker
	Inflation expectations ↓				
4	Real yields ↓	USD ▼	USD ▲	Weaker	Weaker
	Inflation expectations ↓				

Source: RBC GAM

Exhibit 4: Emerging-market external positions are stronger



2. Chinese policymakers appear content to let the renminbi rise. The currency has made new highs not only against the greenback but also against the basket of trading-

partner currencies against which it is measured by the Chinese central bank. A stronger renminbi has become a bellwether for the performance of other emerging-market currencies, particularly those in Asia.

Emerging-market currencies have outperformed their developed-market peers this year and we expect

this trend to continue. However, picking the right currencies to own has become increasingly important because country-specific factors are now playing a bigger role in currency fluctuations. Political developments, COVID-19 vaccination rates and exposure to commodity exports will all play a part in determining which currencies fare best in the coming year.

Canadian dollar

There is lots to love about the loonie these days: the currency has risen 5% this year and ranks among the world’s best-performing currencies in 2021. What makes the Canadian dollar particularly attractive is its exposure to commodities and their link to global economic growth, particularly the strong U.S. recovery. Not only do President Biden’s stimulus checks raise optimism among Canadian consumers and businesses, but they also offer the potential for a more sustained boost to exports. Indexes of Canadian export prices have risen by 60% since the end of 2019 (Exhibit 6), and the boon for exporters is more broad-based than one might expect. According to Deutsche Bank, oil prices make up a fraction of the rise in aggregate export prices over the past year. A more than tripling in lumber prices over the past year is the largest contributor to overall gains, while a host of other metals, energy and agricultural commodities are also up considerably. We have often pointed to Canada’s large current-account deficits as a negative for the loonie, but this headwind seems to be fading with the improvement in exports and the reduction of overseas spending by

Exhibit 5: Emerging-market currencies remain undervalued

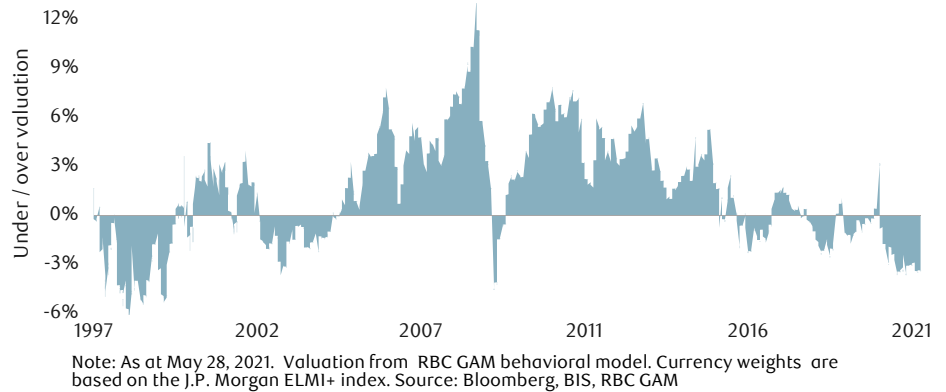
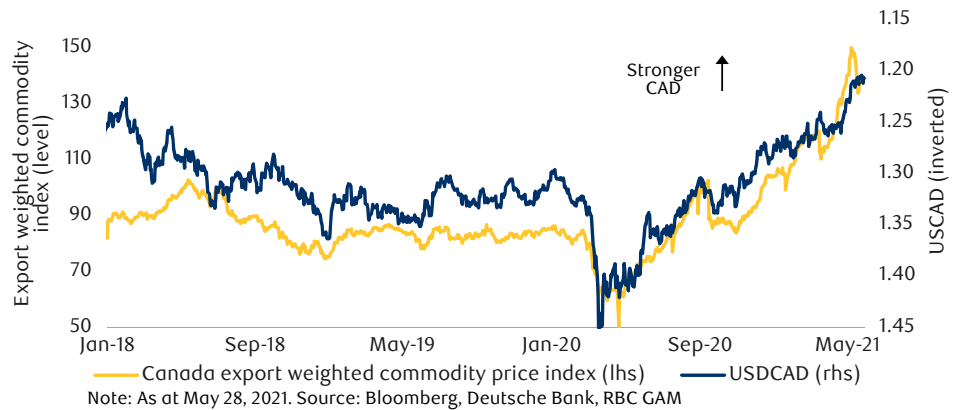


Exhibit 6: Canadian export prices on the rise



Canadians stemming from the pause in travel abroad. Greater cooperation with the U.S. on trade and geopolitical issues will likely lead to further improvement in the Canadian current account, as will several of Biden’s proposed environmental, regulatory and labour-market policies, which could help restore Canada’s export competitiveness relative to its largest trading partner.

The domestic economy is also strong. Pandemic-linked income support,

brisk house-price gains, Canadian fiscal spending and a labour-market recovery that is outpacing the U.S (Exhibit 7) have Canada on track to close its output gap – the maximum level of production that can be sustained without excess inflation – sooner than most other developed economies (Exhibit 8). A ramp-up in the pace of COVID-19 vaccinations has also given the loonie a boost and should allow some lifting of lockdowns now that Canada has caught up to the U.S and U.K in the number of people

who have received at least one dose (Exhibit 9).

Favourable trade trends, improving domestic activity and the prospect of easing lockdowns have prompted the Bank of Canada (BOC) to substantially raise its 2021 economic-growth forecasts. The BOC's expectations for inflation this year were also bumped higher, increasing speculation that the central bank is more open to an overall tightening in monetary policy. The BOC has already started the process of reducing the amount of bonds it will buy each week to \$3 billion from \$5 billion, and rate hikes in Canada are widely expected to materialize sooner than in other major economies (Exhibit 10). The combination of BOC policy changes and Canada's sensitivity to global economic growth is contributing to robust foreign portfolio flows into equities and bonds. It is possible, absent another significant jump in commodity prices, that the loonie's appreciation slows in the near term ahead of the key technical level of C\$1.20 per U.S. dollar. On a 12-month horizon, however, we think that the Canadian dollar has room to strengthen, and we are revising our base-case expectation to C\$1.15 per U.S. dollar now that our previous forecast has nearly been achieved.

The euro

Much of the pessimism surrounding European assets and the decline of the euro in the first few months of 2021 was based on the slower pace of vaccinations and associated lockdowns in Continental Europe. This situation has largely improved and is one of the reasons why the single currency rebounded in April and May.

Exhibit 7: Canadian employment rebound leads the U.S.

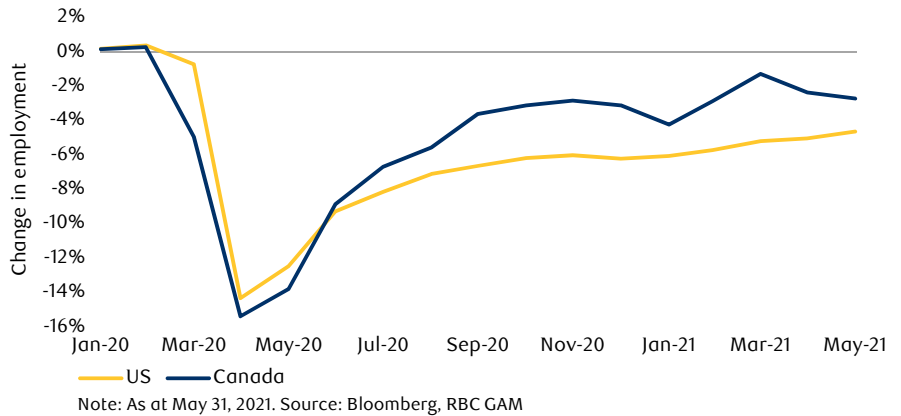


Exhibit 8: Canadian output gap to close by 2022

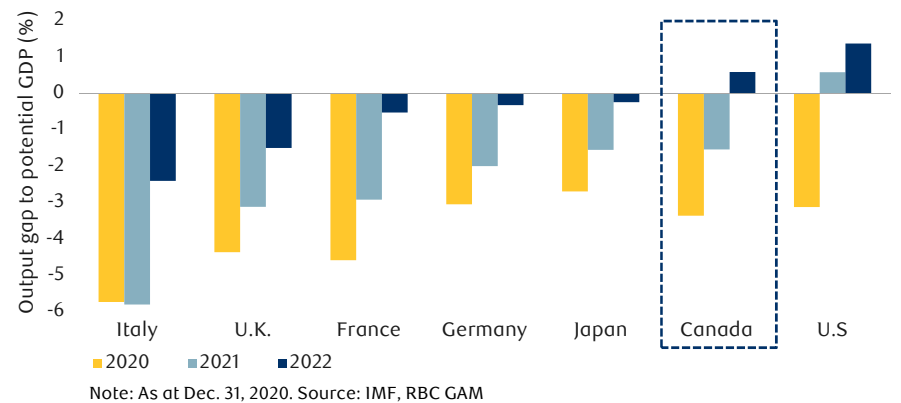
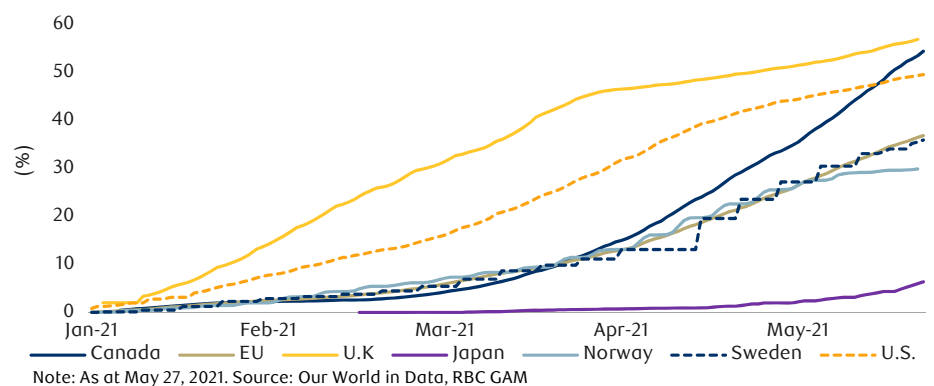


Exhibit 9: Share of people that have received at least one dose



We note, however, that differences in vaccination rates and lockdowns represent temporary factors that are unlikely to drive meaningful shifts in the longer-term valuation of currencies. Like other regions, the eurozone will survive the pandemic, perhaps with higher levels of debt, but without much lasting damage to productive capacity. In fact, European countries were among those that made the most use of wage subsidies and job-retention measures to keep people employed and prevent a loss of workers' skills.

The U.S. economic outperformance that fueled U.S.-dollar strength earlier this year was also temporary in that it was driven in part by more fiscal support in the U.S. than in Europe and most other developed nations. It appears that this could reverse in coming quarters as fiscal spending rises in Europe. In this vein, German elections in September will be important, as a loss in popularity for Angela Merkel's fiscally conservative political party (Exhibit 11) likely means that a more fiscally loose coalition partner will be required to govern – possibly paving the way for more fiscal support across the continent. Most economists expect that the eurozone economy will grow at a quicker pace than its peers beginning in early 2022, a powerful magnet for capital inflows and a definite positive for the currency.

Two other developments during the quarter have also improved the outlook for the euro:

1. The German Constitutional Court struck down legal objections to a 750 billion-euro EU recovery fund, bringing it closer to ratification and to an eventual disbursement of funds

Exhibit 10: G10 central-bank rate-hike expectations

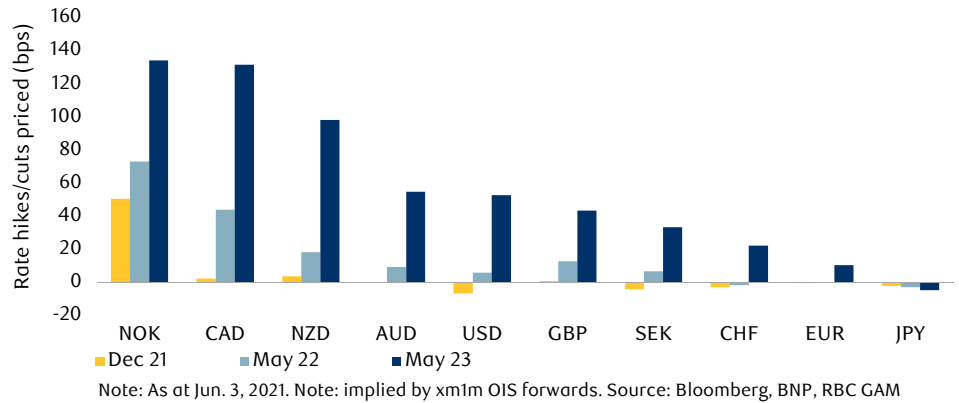
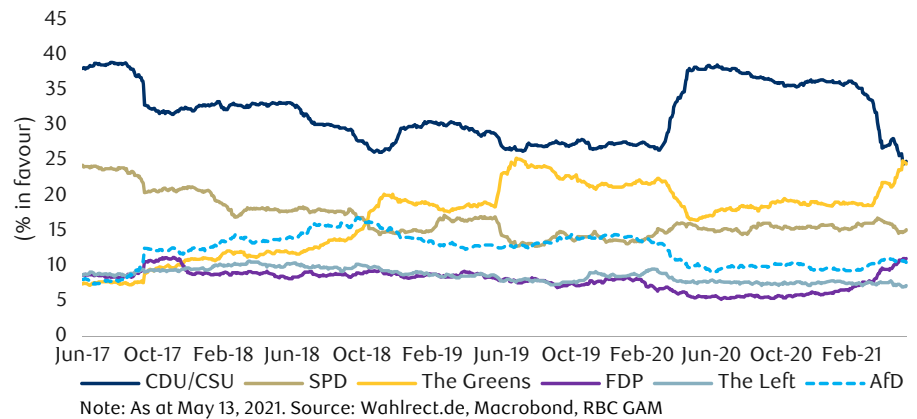


Exhibit 11: Merkel's CDU/CSU coalition is losing support



for European nations to battle the economic impact of the pandemic.

2. U.S. Treasury Secretary Janet Yellen's apparent reluctance to single out currency manipulators suggests that we may see greater foreign-exchange intervention activity, particularly by the most active Asian central banks. Growth in global foreign-exchange reserves is usually euro-positive as it is accompanied by a diversification away from the greenback and into euros.

The next chart point eyed by traders is a euro exchange rate of US\$1.25, which may stall appreciation in the near term. On a slightly longer horizon, however, we think the euro can reach US\$1.30 within the next 12 months.

British pound

Business optimism and consumer confidence have risen in the U.K., likely from the reduced uncertainty around Brexit outcomes, substantial savings built up during the pandemic

and an efficient roll-out of the vaccine program. U.K. growth should get a boost from business investment and would benefit more than other countries from a rebound in retail spending given the large share of consumption in the U.K. economy.

The pound has, however, already strengthened a great deal in recent months, and above US\$1.40, looks to have run ahead of its fundamentals. One risk we're monitoring is the potential for a Scottish move toward independence. The Scottish National Party has pledged to hold another referendum in the first half of its five-year term and polls show that the population remains divided on the issue of independence (Exhibit 12). Scotland matters because it has sizable oil production without which the U.K. current-account deficit would worsen by approximately 2% of GDP (Exhibit 13). We think the pound will hold its ground relative to a falling U.S. dollar, but will likely underperform other developed-market currencies. Our 12-month forecast is US\$1.40 per pound.

Japan

A number of headwinds faced the Japanese yen this year. Among them were a stubborn rise in COVID-19 cases and related mobility restrictions in major population centres including Tokyo. More consequential is the possibility that the Summer Olympics are cancelled – a development that would have a disproportionate impact on Japan's service sector. According to Bloomberg, a last-minute ditching of the Games would wipe out most of the economic growth projected for the country this year.

Exhibit 12: Scottish referendum polling

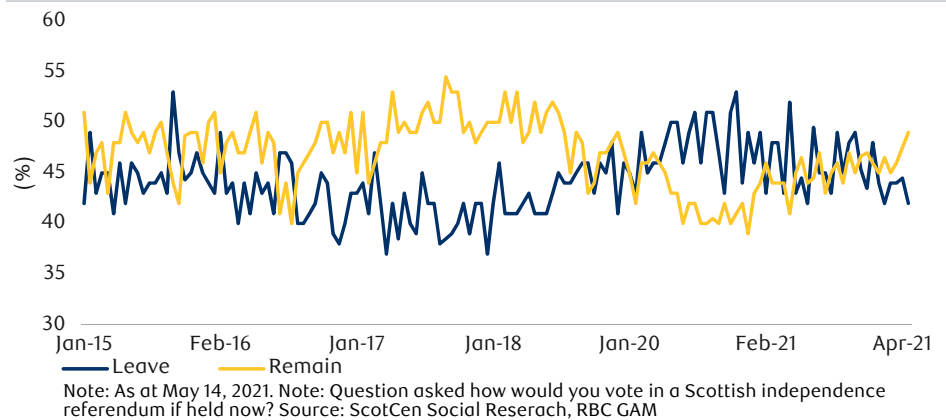
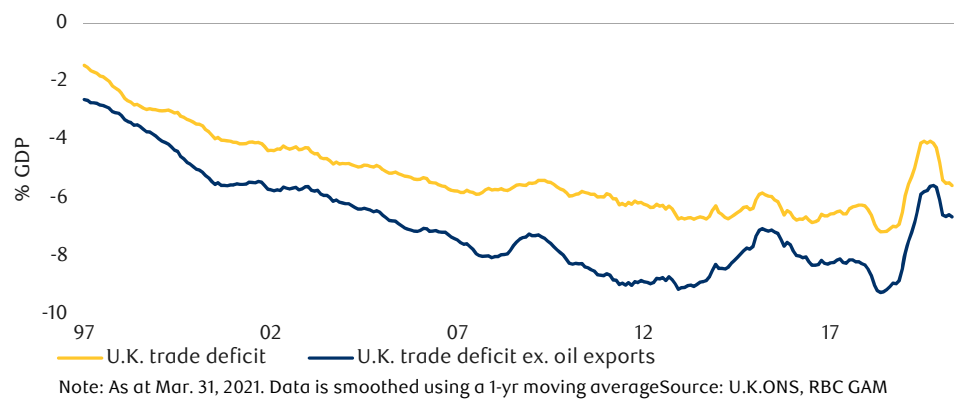


Exhibit 13: Scottish independence could lead to wider U.K. trade deficit



The Japanese yen has been the G10's worst-performing currency this year, as its link to rising Treasury yields was re-established (Exhibit 14). This link should ease going forward as the volatility in U.S. 10-year yields subsides. A number of other factors supporting the yen are its cheap valuation, Japan's improved balance of payments and large short yen positions that we expect will get squeezed as the U.S. dollar declines. Japanese inflation-adjusted yields may also attract capital or stem capital outflows, as they are higher than

in any other G10 country due to the country's persistently low inflation rate (Exhibit 15).

We remain optimistic on the yen, but have learned not to get overly excited about the prospects for large gains in the currency. During this phase of U.S.-dollar weakness, it is the cyclical currencies that should outperform traditional funding currencies such as the yen and Swiss franc, and so we temper our forecast for the coming 12 months to 103 yen per U.S. dollar.

Conclusion

This has been a year of two very different quarters so far – a strong U.S. dollar in the first quarter and a weak one in the second. Our expectations are for the dollar weakness to prevail. The U.S.-dollar bear market began just last year and has a few years to run. Currencies move within cycles, from overvalued to undervalued, and the dollar remains rich despite the weakness of the past year. The stimulative fiscal and monetary policies pursued by the U.S. don't stand in the way of the weakening trend, but instead support it. Cyclical periods of strength, like the one seen in the first quarter, whether driven by real rates in the U.S. or economic weakness in Europe, are good opportunities to position portfolios for a further U.S.-dollar decline. While the early stages of the bear market in the greenback benefits all currencies, it is cyclical currencies, including the Canadian dollar, that benefit most from the global economic recovery underway. Broadly speaking, emerging-market currencies should also continue to gain, although careful monitoring of idiosyncratic risks is necessary to avoid individual currency underperformance.

Exhibit 14: Yen moves in lockstep with U.S. yields

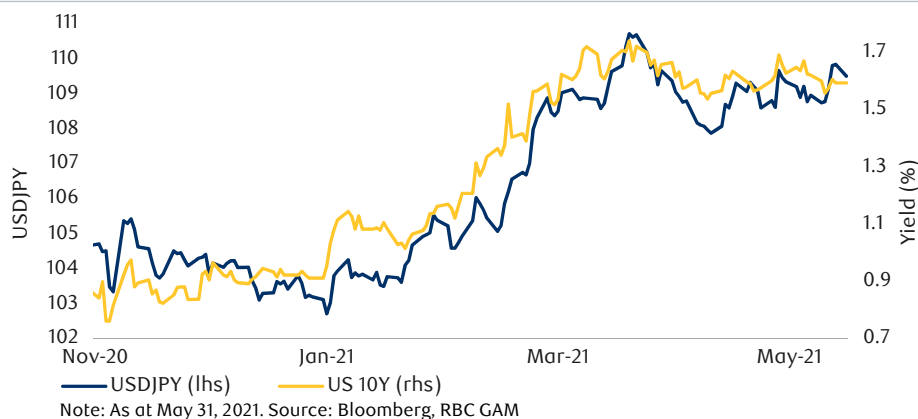
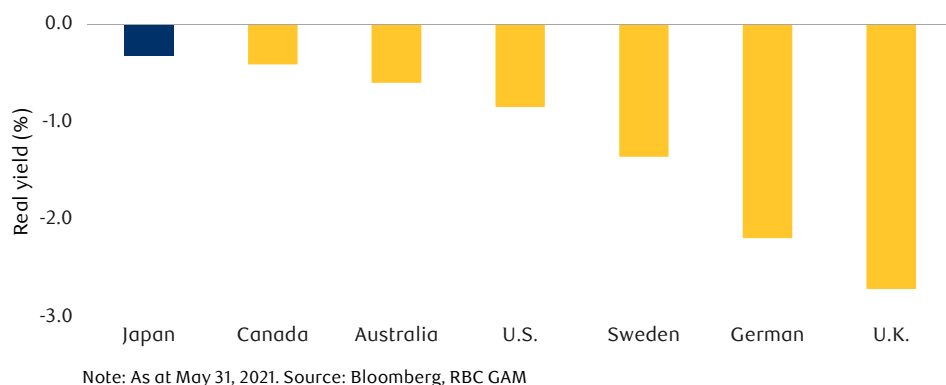


Exhibit 15: Japan offers the highest inflation-adjusted yield among developed countries



Regional Outlook – U.S.

Brad Willock, CFA

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

The state of play regarding the pandemic in much of the U.S. is decidedly positive, and the situation was reflected in the 10.7% rise for stocks during the latest three-month period. The vaccine rollout, one of the world's most successful, has largely halted the spread of COVID-19. The number of new daily cases is down 67% from the mid-April peak and the strain on the hospital system has eased. At the height of the rollout, the U.S. was inoculating roughly 3.5 million people per day, and by early June will have administered over 300 million doses. More than 50% of all U.S. adults are already fully vaccinated, and the Biden Administration's goal is to have over 75% of adults receive at least one dose by July 4. Many states have removed all restrictions regarding masks and social distancing, and most of the rest are rapidly moving toward a full re-opening sometime in June. As a result, personal mobility has improved: road traffic has rebounded; the malls are busy; hotel occupancy is up; more people are flying and taking public transit; and, in the states that are fully open, restaurant reservations are back to pre-COVID levels. Finally, the virus no longer seems to have the upper hand, at least for the moment, leading to continued gains for stocks.

The past year's stock-market returns have been extraordinary, particularly considering that a year ago a significant chunk of the economy was shut down and there was no vaccine

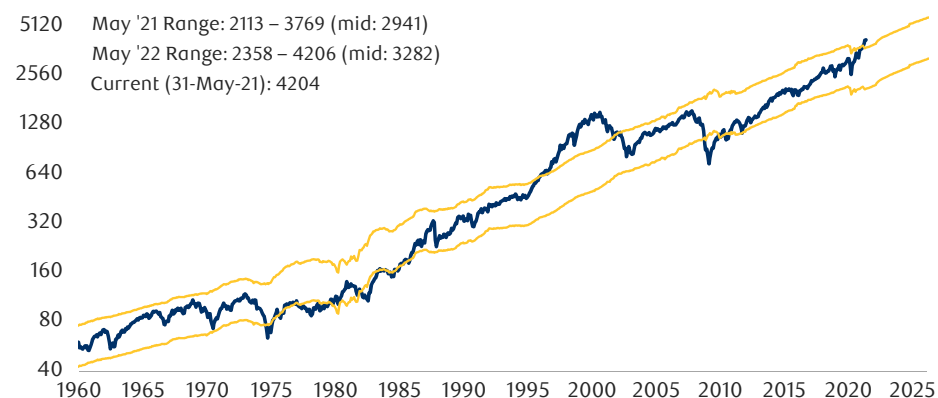
United States – Recommended sector weights

	RBC GAM Investment Strategy Committee May 2021	Benchmark S&P 500 May 2021	Active risk vs. Benchmark May 2021
Energy	3.0%	2.95%	0.1%
Materials	3.0%	2.82%	0.2%
Industrials	9.0%	8.90%	0.1%
Consumer Discretionary	12.0%	11.91%	0.1%
Consumer Staples	5.5%	6.05%	(0.5%)
Health Care	12.0%	12.75%	(0.8%)
Financials	12.5%	11.99%	0.5%
Information Technology	27.5%	26.38%	1.1%
Communication Services	12.0%	11.10%	0.9%
Utilities	2.0%	2.55%	(0.6%)
Real Estate	2.0%	2.61%	(0.6%)

Source: RBC GAM

S&P 500 Equilibrium

Normalized earnings and valuations



in sight. The S&P 500 Index was up 40.3% over the 12-month period to all-time highs, driven by a rapidly improving economy and the resulting surge in corporate earnings. In the most recent quarter, companies in the index generated earnings of roughly US\$50, up about 50% year over year, on revenue growth of 12%, the most

in a decade. Record earnings and the reopening have only just begun. The increase in the S&P 500 in the recent period was led by the Materials, Financial and Industrials sectors. The rally was broad-based, as all 11 sectors registered gains during the period and the average stock in the index increased almost 13%,

indicating that the index return was driven by a growing number of stocks rather than by just a handful of the largest companies. Returns would have been even more impressive had they not been tempered by performance in the Health Care, Energy, Consumer Discretionary and Information Technology sectors. The megacap stocks Amazon, Tesla, Microsoft and Apple held back returns in the Consumer Discretionary and Information Technology sectors.

A pattern of returns characterized by strong overall gains and broad participation is typically seen during the first year following a major market low, as we saw on March 23 of last year. History suggests that returns in the second year following a low are usually better than average, but the market typically experiences more bumps along the way. One note of caution: the current bull market's one-year return is by far the strongest of the 11 bull-market cycles since 1957, and it seems prudent to consider the possibility that we may have borrowed from future gains during the current rally.

The response of monetary and fiscal authorities to the coronavirus crisis was and continues to be extraordinary. Since the pandemic was declared a year ago, the U.S. Federal Reserve (Fed) has injected about US\$6 trillion including loan guarantees into the

financial system, while Congress has passed stimulus bills totaling US\$5 trillion. As the economy rebounds, and employment and inflation pick up, we expect the Fed to gradually begin tightening monetary policy sometime next year. On the fiscal side, the Biden Administration has proposed two bills worth about US\$4 trillion in new spending: the American Jobs Plan focused on infrastructure, broadband access, the electric grid and climate change; and the American Family Plan, which considers education, health care and social inequality. As proposed, the jobs plan would be partially financed by increasing corporate taxes, while the boost to social services would derive its funding partially from increased taxes on high-income individuals. Converting these bills into law as proposed is a long shot. While there is bipartisan agreement on the need for spending on infrastructure, there is no agreement on how to pay for it. Our best guess is that a substantial infrastructure bill will be passed into law this fall, while many of the other priorities will be delayed.

The U.S. economy is mainly driven by household spending, which is at its strongest in 40 years amid huge increases in housing wealth and almost US\$2 trillion in additional savings accumulated during the pandemic. As the re-opening proceeds, the increased mobility should drive increased economic activity and

demand for labour, lifting consumer confidence and leading to even more economic activity and job creation. This positive feedback loop should last well into next year and supports a cyclical orientation in our portfolios.

Many companies have noted rising cost pressures due to increasing prices for raw materials such as steel and lumber, as well as prices for shipping. We expect these price increases to be temporary, as they start to attract competition and increase supply. In addition, the shift from spending on things to spending on services ought to ease supply-chain pressures and put a cap on prices for goods.

The S&P 500 remains expensive at a price-to-earnings multiple of 21 times the consensus 12-month earnings estimate of US\$198, compared with a trailing five-year average of 18. It seems clear to us that valuations are likely to remain high until macroeconomic risks start to creep back. Potential sources of risk include a significant rise in interest rates, increased regulations and taxes, disappointment in Congress's efforts to pass an infrastructure bill and the unchecked spread of COVID-19 variants. Of these risks, tighter regulation and higher taxes seem highly likely sometime in the next 12 months.

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 surged into the end of May, reaching new highs and gaining 10.0% in the latest three-month period in Canadian-dollar terms. In U.S. dollar terms, the S&P/TSX returned 16.0%, supported by recent strength in the Canadian dollar. This was well ahead of the S&P 500 Index, which returned 10.7%, and the MSCI World Index, up 9.7%. Continued optimism about the progress of COVID-19 vaccinations in much of the developed world, strong economic data and escalating commodity prices have supported market returns, and sectors well positioned to benefit from the economic rebound and emergence from the lockdowns led the rally. Looking ahead, a continued economic recovery and growth in corporate profits will be needed to support further equity returns. Inflation expectations and the outlook for the trajectory of interest rates remain important indicators for future equity-market returns. The Canadian stock market's sizeable exposure to financial services and commodities should boost its relative performance in a global economic recovery.

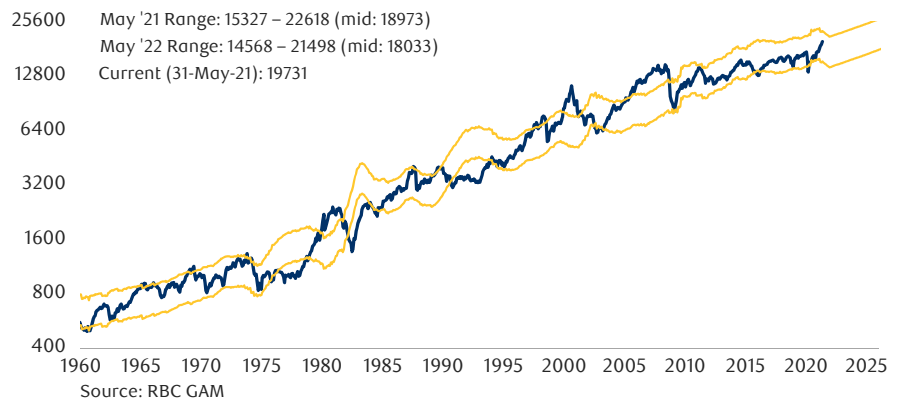
A third wave of COVID infections and extended lockdowns have stifled domestic economic momentum somewhat. Canada's initially slow vaccination rate has picked up and should allow the economy to re-open over the summer, leading to improved business and consumer confidence.

Canada – Recommended sector weights

	RBC GAM Investment Strategy Committee May 2021	Benchmark S&P/TSX Composite May 2021	Active risk vs. Benchmark May 2021
Energy	13.0%	13.0%	(0.0%)
Materials	13.0%	12.7%	0.3%
Industrials	12.0%	11.6%	0.4%
Consumer Discretionary	5.0%	4.0%	1.0%
Consumer Staples	3.5%	3.6%	(0.1%)
Health Care	1.0%	1.4%	(0.4%)
Financials	33.0%	31.7%	1.3%
Information Technology	8.0%	9.4%	(1.4%)
Communication Services	5.0%	4.9%	0.1%
Utilities	4.0%	4.5%	(0.5%)
Real Estate	2.5%	3.1%	(0.6%)

Source: RBC GAM

S&P/TSX Composite Equilibrium Normalized earnings and valuations



We expect the Canadian economy to experience a consumption-led rebound in the second half of the year, supported by the substantial savings that many households have accumulated. The Bank of Canada (BOC) has indicated that monetary stimulus will continue to support the recovery, albeit at reduced levels, until inflation drops back closer to its 2 percent target,

which it now expects in the latter half of 2022. The overnight rate is expected to remain at 0.25% until that time. The BOC has also supported the recovery through a bond-purchase program that will be scaled back as the recovery advances. In the most recent budget, Finance Minister Chrystia Freeland pledged to provide additional stimulus over the next three years to boost economic growth. Some critics

question the merit of further stimulus as consumer spending is on track to exceed pre-pandemic levels. Canadian home prices continue to surge in most markets and have supported strong GDP figures. Low borrowing rates and extremely tight supply have supported prices and squeezed affordability, especially for single detached homes. The federal budget did not address the issue of rising housing prices.

The corporate-earnings outlook has improved substantially over the past six months. S&P/TSX consensus earnings are forecast to return to pre-pandemic levels and grow by 66% in 2021, with a further gain of 8% forecast for 2022. Full-year estimates have been raised as a majority of businesses beat expectations to start the year. The Materials, Consumer Discretionary, Financials and Energy sectors drove the earnings upgrades. The valuation of the market is slightly higher than the historical average, with the S&P/TSX forward price-to-earnings multiple at 16.5, a still significant discount to the S&P 500's comparable 21.3. The S&P/TSX could tighten the valuation discount in a recovery scenario, given the significant weighting of the Financials and Energy sectors in the earnings composition and expectations that those sectors will perform exceptionally well in a scenario of faster economic growth. The Information Technology, Industrials, Utilities and Health Care sectors are trading at premiums to their historical valuations. These four sectors represent over 27% of the S&P/TSX's market valuation.

The operating environment for Canadian banks is a mixed bag as the strong performance of their wealth-management and capital-markets units, propelled by rising stock markets, helps offset a slowdown in income from lending in the low interest-rate environment and subdued demand for consumer loans. Banks are well positioned for an economic reopening, with growth expected to come from higher credit-card use, commercial lending and wider profit margins on loans when the BOC and the U.S. Federal Reserve start monetary tightening. Provisions for credit losses will remain below historical levels in 2021 as banks reverse provisions that had been set aside to cover bad loans when the pandemic first 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 restrictions are lifted. We expect 2021 earnings to surpass pre-pandemic levels, with year-over-year growth of about 35%, and expect the banks to seek acquisitions in the U.S.

Oil-market fundamentals have stabilized as global demand continues to recover from last year's historic drop. Global crude-oil inventories are declining with improving demand for transportation offsetting the impact of what we expect will be healthier supply. At current prices, we estimate that Canadian producers will generate significant free cash flow after paying dividends. Energy producers continue to focus on debt reduction, cost-cutting

and production rather than expanding reserves, an approach that should ultimately result in higher dividends and stock repurchases.

The outlook for Canada's railroads has improved in recent months as rising shipments have enabled the companies to raise prices. Their prospects are reflected in historically high price-to-earnings multiples of about 20. The industry is also focused on the potential consolidation. The outcome of recent major acquisition announcements in the railway space is still highly uncertain, with multiple scenarios possible given doubts about U.S. regulatory approval. In the end, the absence of a long bidding war makes it likely that the winner's earnings will not be shackled for years by an excessive purchase price.

The Materials sector has been supported by renewed strength in gold prices, as inflation creeps higher, the U.S. dollar weakens and interest rates remain at persistently low levels. Gold companies are positioned to benefit from higher prices and valuations remain attractive. Industrial metals have also made significant gains as demand returns and supply has been hampered by labour disruptions and efforts by some countries to boost their share of mine proceeds. Efforts to reduce pollution through "green" technology will provide steady demand for metals like copper and cobalt, which are used in a variety of electrification applications.

Regional Outlook – Europe

Dominic Wallington

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

European markets have been robust since late February, with the EuroStoxx 600 Index rising about 10% in local currency. European leading indicators are also showing strength since touching lows during the early height of the pandemic, and GDP growth is expected to peak at some stage in the third quarter of this year. Earnings expectations are rising globally, offering solid support to Europe's stock markets.

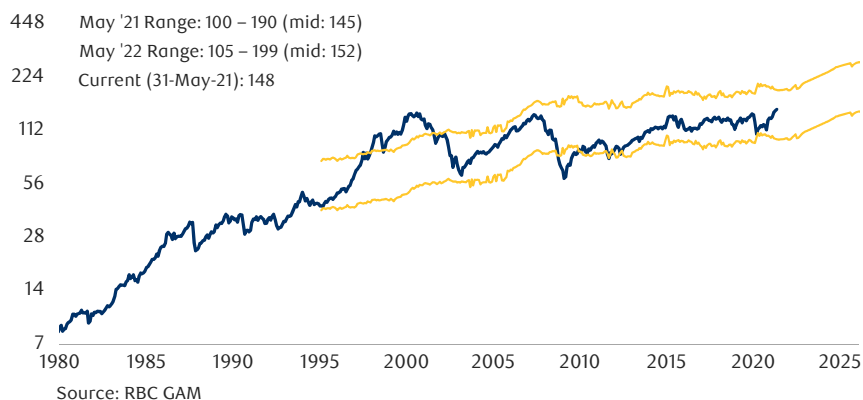
The key concern for investors over the past year has obviously been the effectiveness of attempts to get the coronavirus under control. While the timing and extent of lockdowns has varied somewhat across the region, all countries have had success in containing the spread of COVID-19. Vaccinations offer the next leg of protection and, again, there has been some variance in terms of how quickly countries have rolled them out. The vaccination process has been especially successful in the U.K., but Continental Europe has been among the leaders in delivering shots, and we are optimistic that the worst is now behind us as vaccination programs accelerate over the summer. By late April more than 1 billion vaccine doses had been administered globally, equivalent to 13 doses for every 100 people, according to the New York Times. This figure obscures the fact that most of those vaccinations have taken place in developed countries. The U.S. will now provide vaccines to

Europe – Recommended sector weights

	RBC GAM Investment Strategy Committee May 2021	Benchmark MSCI Europe May 2021	Active risk vs. Benchmark May 2021
Energy	3.6%	4.5%	(0.9%)
Materials	8.9%	8.4%	0.5%
Industrials	15.5%	14.8%	0.7%
Consumer Discretionary	13.1%	12.3%	0.8%
Consumer Staples	12.6%	12.8%	(0.3%)
Health Care	13.0%	13.4%	(0.4%)
Financials	16.8%	16.3%	0.5%
Information Technology	8.6%	8.0%	0.6%
Communication Services	3.4%	3.9%	(0.5%)
Utilities	3.5%	4.3%	(0.8%)
Real Estate	1.1%	1.3%	(0.3%)

Source: RBC GAM

MSCI Europe Index Equilibrium Normalized earnings and valuations



COVID-ravaged India, and hopefully such assistance is a sign of things to come.

The U.K. has shifted away from economic austerity, and we think it likely that the government will continue with expansionary fiscal policy until at least 2023. In Continental Europe, a large economic recovery plan was adopted in February

of this year. Such responses by central authorities should work to insulate the European economies from the worst of the pandemic. Both plans focus on “green” technology and other new areas of innovation, and will help the region to develop its capabilities in terms of digitization and the transition to cleaner energy.

The next German federal election will take place later this year in September. The traditional big-tent parties continue to suffer from a decline in voter support, and it is possible that the Green Party will come to power in a coalition and that its leader, Annalena Baerbock, could become the new chancellor. Such an outcome would raise the possibility that Germany turns its back on economic austerity, echoing developments we have seen in the U.S. Much of this about-turn would be directed toward addressing climate change and will again ensure that Europe has a leading position in this area.

In the short term, equity markets have been led by improving macroeconomic indicators, and earnings expectations have dutifully improved in recent months as well. The style characteristics of stock markets in Europe have followed the path of a classic cyclical recovery, and cyclical stocks have outperformed the growth/defensive areas of the market by 55% since equity markets started to turn up in March 2020. At these times, the breadth of the market narrows and lowly rated companies that have underperformed in the

preceding downturn tend to perform very strongly. During the current cycle, the sector that has most consistently outperformed during the upturn has been Financials, and within it, banks and insurance companies.

There have been recent signs that lagging areas of the stock market might start to catch up with those that had already begun to reflect an economic recovery. One example is makers of alcoholic beverages, located in the Consumer Discretionary sector. These companies have underperformed in part because they have in many instances been affected by closures of pubs, bars and restaurants during the pandemic. As long-term investors, we were aware that after a very strong run in 2020 many of our favoured companies could lag badly towards the back end of the year and into the first half of 2021. We therefore re-allocated assets within the portfolio to offset the risk of market rotation. While there is room for further cyclical outperformance, we believe the bulk of the move has taken place and we are currently rotating back into our favoured high-quality companies. The prospect of some cyclical upturn in the Consumer

Staples sector as lockdowns ease makes us especially keen to rebuild positions here and in sectors that have been hit for similar reasons in the past year or so.

In conclusion, missteps and recriminations aside, it is possible that future generations will look back and think that Europe dealt with COVID-19 fairly well. Many risks remain: vaccination programs may stall; dangerous new variants may emerge; the political viability of lockdowns may exhaust itself. But given the scale of the problem and its lack of precedent in living memory, the response has been acceptable in our view. A number of trends that emerged in the past few years have been accelerated by the pandemic. Politicians in Europe are beginning to move away from wholesale support for austerity, and digitization has leaped forward and is changing the rules in many industries. We believe the changes to come will benefit the types of companies in our portfolios. Many of these companies have shown their ability to thrive in periods of disruption and demonstrated this ability over long periods of time.

Regional Outlook – Asia

Chris Lai

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

Asian equities pulled back over the past three months after reaching record highs in February, as a resurgence in COVID-19 cases in India and Southeast Asia offset faster global economic growth and expectations that private consumption would recover in the second half of 2021. Progress on vaccinations in much of Europe and North America has helped to accelerate global growth, as has increased demand for technology and easier financial conditions. In the recent three-month period, equity markets in Singapore, Australia and India outperformed, while China, Indonesia and the Philippines lagged the benchmark.

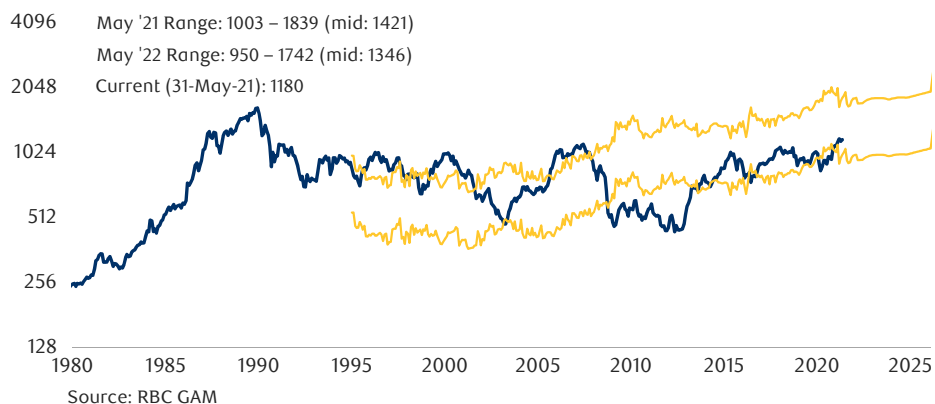
Going forward, even faster economic growth, in our view, is likely in China, India, Singapore and South Korea, while growth in Thailand, Malaysia and Philippines is likely to disappoint. Inflation is rising given higher commodity prices, supply-chain bottlenecks and the fact that prices were depressed by the pandemic in the year-ago period. We expect central banks to leave policy rates unchanged this year, but policy hikes are likely next year in China, India, Indonesia, Malaysia and the Philippines. We remain optimistic about the outlook for Asian equities but are keeping a close eye on the shift away from highly valued growth sectors since the fourth quarter of 2020. Singapore has benefited from this style rotation, whereas China, which is driven by growth stocks, has not.

Asia – Recommended sector weights

	RBC GAM Investment Strategy Committee May 2021	Benchmark MSCI Pacific May 2021	Active risk vs. Benchmark May 2021
Energy	1.8%	2.1%	(0.3%)
Materials	6.9%	6.4%	0.5%
Industrials	10.4%	10.9%	(0.5%)
Consumer Discretionary	17.8%	17.1%	0.7%
Consumer Staples	5.1%	5.6%	(0.5%)
Health Care	7.3%	7.2%	0.1%
Financials	17.1%	17.1%	0.0%
Information Technology	18.6%	18.0%	0.6%
Communication Services	10.1%	9.6%	0.5%
Utilities	1.4%	1.9%	(0.5%)
Real Estate	3.5%	4.1%	(0.6%)

Source: RBC GAM

MSCI Japan Index Equilibrium Normalized earnings and valuations



Japan

We expect the impact of COVID-19 on Japanese economic activity to recede, and that Prime Minister Yoshihide Suga and the Bank of Japan (BOJ) will therefore be unlikely to pursue the same degree of stimulus as was required last year. Strong exports are helping to offset the negative impact of COVID-19, rising 38.0% year over

year in April for the fastest increase in 11 years, and following a 16.1% rise in March. The gain was due to U.S.-bound auto-related shipments and Chinese demand for chip-making equipment. Also supporting a stronger outlook were a 0.6% month-on-month rise in the April manufacturing purchasing managers' index and a 3.5% gain in export orders. Household spending

appeared to be strengthening through March, but turned weaker in April, as COVID-19 cases surged in some regions. Second-quarter inflation is forecast at 0.4% after a year of steady deflation. The rebound in prices is due to government stimulus, the release of pent-up consumer demand and higher crude-oil prices. The BOJ will likely focus on maintaining financial conditions through bond transactions and lending programs. Employment has been holding up surprisingly well, with the 2.9% jobless rate in the first quarter of 2021 not much higher than the 2.4% rate before the spread of COVID-19.

Rest of Asia

Asia's economic recovery has been strong, albeit uneven. China and South Korea have continued to outperform the rest of region, and emerging markets such as Thailand and Philippines remain relatively weak.

In China, we expect the growth recovery to continue, and for Beijing to withdraw economic stimulus in the coming months. However, significant changes in policy are unlikely in our view. The economy surged year over year in the first quarter. Growth in exports, industrial production and retail sales all beat consensus

forecasts, while growth in fixed-asset investment was weaker than expected. Chinese GDP rose 18.3% in April from a year earlier and full-year GDP growth is forecast at 8.8%. We expect, however, that year-over-year economic activity will start to decline. Beijing has pledged to make the withdrawal of policy stimulus gradual and moderate, with only a modest slowdown in credit growth. We believe that China will try to hold interest rates down while limiting funding for property, and favour high-end manufacturing.

South Korea's economic recovery has been gathering steam, with continued strength in exports and a faster-than-expected pick-up in private consumption following last year's contraction. Consumer sentiment has risen to near a one-year high, and major department stores announced year-over-year sales growth of about 50% in March to re-attain 2019 levels. We expect consumer spending to continue its gradual recovery given vaccinations and fiscal stimulus. GDP in 2021 is forecast at 3.6%, compared with a 1.0% decline in 2020.

The growth outlook in Thailand remains weak relative to its Asian peers. GDP growth is forecast at 2.1% in 2021, compared with a drop of 6.1%

in 2020. This lag is due to the slowest rollout of vaccines in the Association of Southeast Asian Nations, sluggish border re-openings, political protests and a new wave of COVID-19 infections. Just 0.2% of the population had been vaccinated as of April 6. The country's current-account deficit is almost double what it was late last year, as the tourist-dependent economy gets whacked by rising oil prices, surging gold imports and higher freight costs.

The outlook for the Philippines also remains weak. The pandemic will be entrenched until vaccines start to arrive in significant amounts in the first quarter of 2022, and Manila and nearby provinces remain under stiff lockdowns. The Manila metropolitan area accounts for about 50% of the country's GDP, and the negative impact on economic activity will be significant in the second quarter given a dearth of government stimulus. The unemployment rate was 8.7% in the first quarter of 2021, compared with 5.3% before the pandemic.

Regional Outlook – Emerging Markets

Philippe Langham

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

Emerging markets have in recent months ceded some of their recent outperformance versus developed markets due to a first-quarter rally in the U.S. dollar and a sharp decline in Chinese stocks, which account for a significant portion of the emerging-market index.

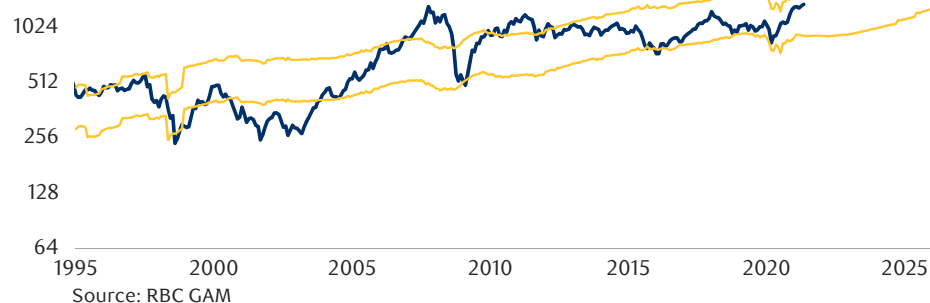
This performance masks the dramatic change in style leadership that kicked off in late 2020, as optimism over the reopening of economies led to outperformance in value and cyclical stocks following several years of underperformance. The shift was supported by a backdrop of pent-up demand, along with loose U.S. monetary and fiscal policy that led to rising inflation expectations.

The strong performance of growth stocks in recent years has left the emerging-market growth index expensive relative to the emerging-market value index. The most expensive decile of stocks in the MSCI Emerging Markets Index experienced an unprecedented increase in valuation relative to history and other segments of the market based on both book value and earnings. The valuation premium that the most expensive stocks have built up in recent months is not explained by an improvement in relative profitability. Indeed, the return on equity of the most expensive decile of emerging-market stocks has declined significantly in recent years in both absolute and relative terms.

MSCI Emerging Markets Index Equilibrium

Normalized earnings and valuations

4096 May '21 Range: 926 – 1559 (mid: 1243)
2048 May '22 Range: 925 – 1559 (mid: 1242)
Current (31-May-21): 1376



The exposure of our emerging-market funds to the highest-growth companies, which we believe are too expensive, is relatively limited. Meanwhile, the rally in value stocks has supported the stocks of companies with the very cheapest valuations. As a result, we have a clear preference for the middle segment of quality stocks and can find companies in this area trading at sensible valuation levels. We remain cautious on both the most expensive parts of the market and on deep-value areas where companies struggle to earn their cost of capital.

We have seen a wide gap in the performance of markets and sectors in recent years. Much of the difference in country performance can be attributed to the sectoral make-up of indexes, with countries that are more cyclical and exposed to financials, like Turkey and Chile, looking cheap relative to history. Taiwan, on the other hand, with its high exposure to technology, looks expensive. Most emerging-market countries are trading just above long-term average valuation

levels in line with the overall index. Going forward, we are particularly positive on the outlook for India, which offers a good choice of high-quality companies. Latin American markets have recorded disappointing performance over the past year, but a combination of attractive valuations, economic recovery and policy improvements support a more optimistic outlook against a backdrop of political uncertainty. In China, market liberalization and financial reforms are positives, and we believe that the trade war will provide China with a strong impetus to achieve its longer-term goals of technological leadership and self-sufficiency. Our biggest concern on China is the presence of extended valuations of higher-quality growth companies.

A key change we see in the composition of the MSCI China Index is the increased importance of internet-related companies, which now comprise about 50% of the index's market capitalization, surpassing the historic dominance of Financials,

Energy and Materials. The surge in the valuation gap between internet stocks and slower-growth sectors has resulted in an acceleration in this weighting difference.

Stark valuation differences remain throughout emerging markets at the sector level. The sectors that have benefited from COVID, such as Health Care, Consumer Discretionary (largely e-commerce in emerging markets), Communication Services (dominated by social media) and Information Technology, all look overvalued. On the other hand, the Financials and Energy sectors trade at low valuations. We favour the consumer sectors, which are driven by high returns and tailwinds such as rising incomes, economic reforms, attractive demographics, increased urbanization and employment trends. Among cyclical sectors, we prefer Financials on valuation, improving asset quality, low penetration and structural growth. We are gradually reducing exposure to the more expensive internet-related parts of the market. In addition to concerns on valuation, we see increasing signs that internet companies will face headwinds in the forms of competition, regulation and higher taxes.

From a country standpoint, we are focused on areas of emerging-market vulnerability if global bond yields continue to rise. Historically, emerging markets with high current-account deficits have suffered in this sort of environment. However, we note that the most fragile five emerging markets – South Africa, Turkey, Brazil, Indonesia and India – have all undergone significant improvement in their current-account deficits since the “taper tantrum” of 2013.

Changes in the performance of emerging-market equities relative to developed markets tend to occur in waves, with long periods of strong outperformance followed by long periods of underperformance. Emerging markets outperformed strongly between 2000 and 2010, but have mostly underperformed for the past decade. The factors that generally drive the relative performance of emerging markets have been the U.S. dollar and the size of the gap in economic growth and earnings between emerging and developed markets. Looking forward, we believe that the case is relatively strong that these factors will turn positive and that emerging markets will enter a period of outperformance.

Following a decade of strong performance, the U.S. dollar looks expensive based on most valuation measures. The combination of aggressive monetary and fiscal easing in the U.S., which have led to a surge in the U.S. current-account deficit and rising fiscal deficits, supports a weaker greenback. While policy is loose in the U.S. and most other developed markets, the reverse is the case in China, where targeted tightening is taking place. China has set relatively conservative growth targets, prioritizing the management of excess leverage with the aim of bringing credit growth in line with nominal GDP. The tightening bias is also reflected in a continuing squeeze of residential property, with limits on developers’ financial ratios and real estate lending. China’s tightening bias is leading to strong support for Chinese bonds, which have attracted substantial foreign capital, and this relatively conservative policy stance suggests long-term renminbi appreciation.

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 \$568 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 May 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.



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 PH&N Canadian Income Fund and the PH&N Monthly Income Fund. 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.



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.

Jaco is Vice President and Global Head of Quantitative Research & Investments at RBC Global Asset Management Inc. He joined RBC GAM in 2019 to ensure that systematic investing thrives at the firm and to help futureproof the quant business in a world of rapidly evolving technologies and alternative data. Prior to joining, Jaco held an executive role at one of Africa's largest financial services companies, leading the Investment Management Office and working across pension funds, insurance, banking, and wealth management. He also chaired the boards and investment committees of several pension plans and has a track record in driving transformational change. He obtained a Doctor of Commerce (Economics) in 1997 from the University of Pretoria and a Masters of Arts in Economics in 1994 from the University of Toronto.



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.

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