GLOBAL Insight WEEKLY

Perspectives from the Global Portfolio Advisory Committee

November 30, 2023

# Looking back, looking ahead—with guarded optimism

Joseph Wu, CFA – Toronto

As we approach the end of 2023, we reflect on key macro developments that have defined the year so far. We also look at potential risks investors should monitor heading into leap year 2024.

## Reasons for confidence

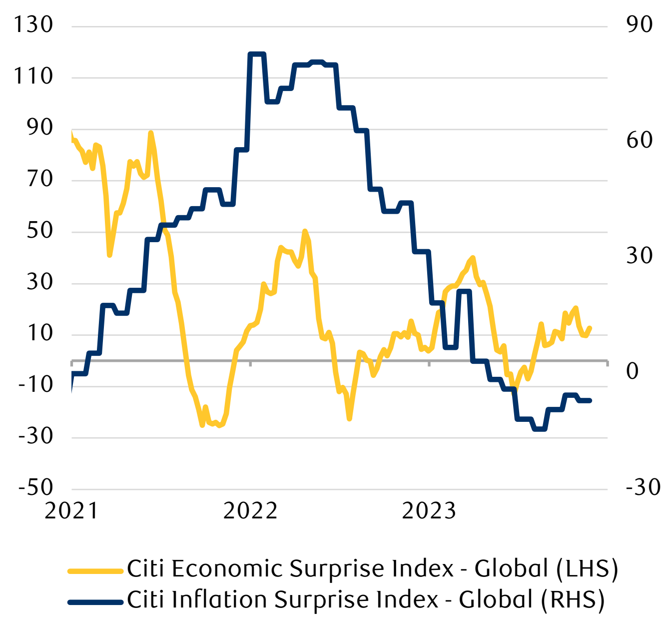
Despite gloomy projections heading into 2023, another push higher in interest rates, and geopolitical upheaval, the world economy managed to exceed expectations. The U.S. economy, as the major engine for global growth, continued to prove its mettle, performing stronger than the rest of the world on the back of steadfast household spending, reinforced by steady job creation and income gains.

Firmer-than-anticipated economic growth enabled corporate profits to exceed subdued forecasts. Not unlike those for the first two quarters of the year, Q3 earnings for large-cap U.S. and European companies came in better than expected, with roughly 80 percent and 60 percent, respectively, of companies reporting positive surprises.

Finally, inflation receded considerably from worrisome levels in most economies thanks to a combination of lower energy prices, base effects from year-over-year comparisons, and slower demand for goods and services. This has allowed most major central banks, including the Federal Reserve, to shift to a more balanced stance on the trade-offs between the path of interest rates, inflation, and growth.

**A favourable mix of surprises**

Upside growth, downside inflation




Note: Surprise indexes measure how economic data compares with consensus expectations.

Source - RBC Wealth Management, Bloomberg; data through 11/24/23

For perspectives on the week from our regional analysts, please see pages 4–5.



For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 7.

Priced (in USD) as of 11/29/23 market close (unless otherwise stated). Produced: 11/30/23 1:31 pm ET; Disseminated: 11/30/23 1:43 pm ET

## Reasons for prudence

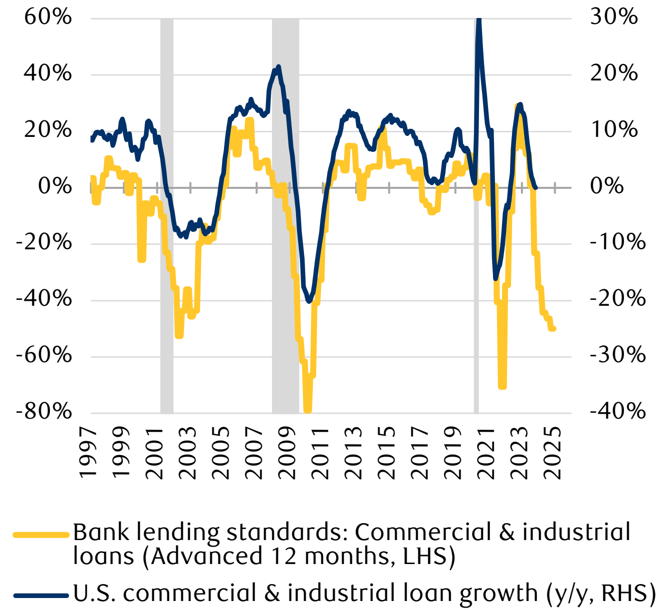
Cautious optimism and resilience remain apt descriptors for the global economy, but we believe growth prospects will continue to be tested by a mix of persistent headwinds. A significant source of uncertainty stems from the progressive impact of the rate hikes that have already been deployed by many central banks around the world.

As price pressures have subsided to more palatable levels, it looks like we may have finally reached a plateau in interest rates. Although central bank officials in the U.S., Canada, and Europe have signaled a desire to pause rate hikes, they have also been guiding markets to expect interest rates to linger at higher levels for longer, given inflation is still at above-target levels.

Higher rates and a reduced willingness of banks to extend loans suggest to us that credit conditions for households and businesses are likely to remain challenging in the near term (see top exhibit). Restrictive borrowing costs and tougher access to credit tend to act as drags on economic activity. After consistent positive revisions this year, the current consensus projections are for global and U.S. real GDP growth to moderate to 2.7 percent and 1.2 percent in 2024, on a year-over-year basis, respectively, from 2.9 percent and 2.4 percent this year.

These forecasts partially reflect the view that the effects of higher interest rates will continue to permeate the economy by tapping the brake on private sector activity. Signs of strain from the monetary tightening campaign are starting to show up in various pockets of the economy. Most major economies are generating fewer jobs relative to a year ago, while wage gains have decelerated, job openings have fallen, and corporate default activity has begun to pick up. The good news is that most of these metrics are worsening from very healthy starting points, but the risk is that they could continue to trend in the wrong direction heading into next year.

### Loan growth looks set to slow further




Note: Bank lending standards is the net percentage of banks tightening or loosening standards

Source - RBC Wealth Management, Bloomberg; data through 10/31/23

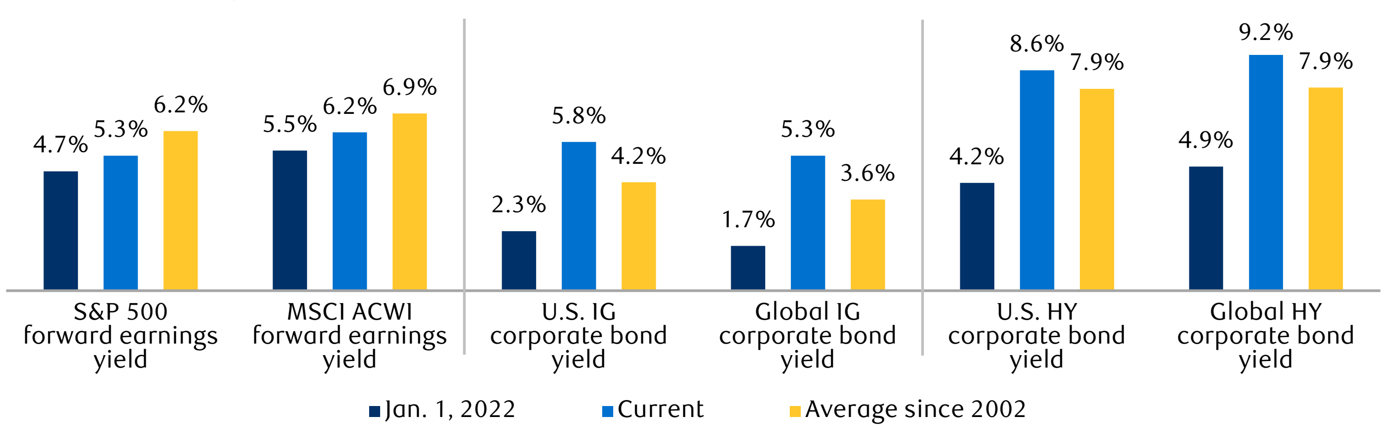
## Investment takeaway

The story for much of 2023 has been a macro environment that has generally surprised in a constructive way. Sustained economic growth and central banks that are now less motivated to hike again provided a more supportive environment for equity markets to scale the proverbial "wall of worry."

We acknowledge that receding inflation and sturdy labour markets have made it easier for investors to envision a more upbeat outlook for major economies. However, we

### Return potential in bonds remains attractive

Valuations across major asset classes*




*Earnings yield is the inverse of the forward price-to-earnings ratio. Bond yield refers to yield to worst for the Bloomberg U.S. Corporate Index, the Bloomberg Global Agg Credit Index, the Bloomberg U.S. Corporate High Yield Index, and the Bloomberg Global Corporate High Yield Index.

Source - RBC Wealth Management, Bloomberg; data through 11/24/23 are mindful that it is difficult to distinguish between the typical growth slowdown preceding a “soft landing” and one that eventually lands in a deeper economic downturn.

Meanwhile, the longer rates are kept at restrictive levels, the greater the likelihood that they start to materially weigh on the economic activity as consumers and businesses would increasingly feel the pinch of the more expensive cost of borrowing and refinancing over time.

Consensus estimates are currently projecting low double-digit profit growth for major equity indexes in 2024. While these full-year numbers are usually revised lower as the new year progresses, our sense is that as long as the world economy maintains an upward trajectory, this should allow companies to surpass (lowered) earnings estimates over the coming quarters.

For most portfolios, we continue to view an “up-in-quality” approach to allocations as sensible. Within equities, this can be expressed through a preference for companies with more consistent cash flows, lower debt levels, and/or growing dividends—quality and defensive attributes that can help strengthen resilience in equity portfolios if economic conditions begin to undershoot market expectations.

The additional upward repricing of interest rates in 2023 has dented returns in fixed income markets. But the silver lining of the substantial pullback in bond prices (higher bond yields) over the past 20 months is that expected returns and the overall risk-reward profile in bonds have improved greatly. Even though bond yields have fallen somewhat recently, we continue to see a compelling case for allocating into fixed income, with many bond markets offering ample opportunities to deploy capital and lock in all-in yields ranging from mid-to-high single digits (see bottom exhibit on previous page). Historically, the end of rate hike cycles has typically brought with it a more favourable environment for fixed income securities.

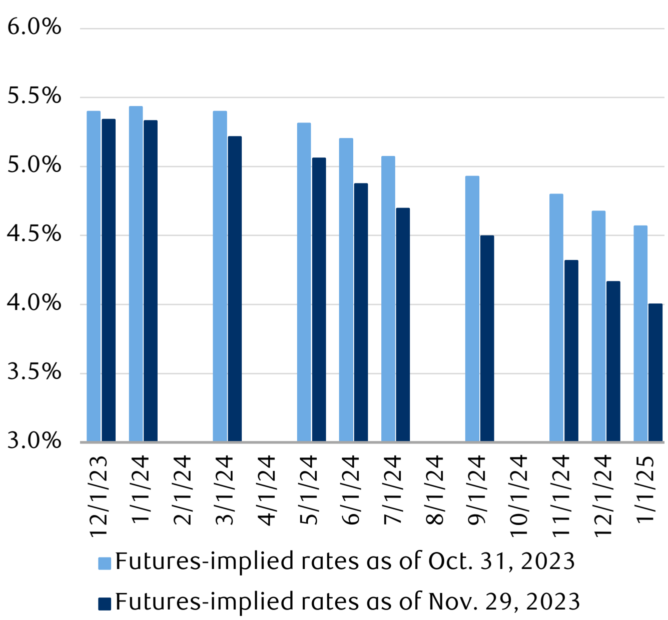
## UNITED STATES

Atul Bhatia, CFA – Minneapolis

- Expectations for less restrictive monetary policy in 2024 strengthened this week. **Interest rate futures now reflect a high probability that the Federal Reserve cuts overnight rates by more than 1.35% next calendar year**, with essentially no chance of further rate hikes. At the start of November, investors were projecting a 40% chance of an additional hike with only 0.75% of likely cuts. We see numerous catalysts for the increased policy optimism. Rising unemployment with slowing inflation data—including a flat monthly Consumer Price Index reading—were the primary drivers, assisted by multiple central bank officials indicating satisfaction with the current inflation trajectory.

- Positive sentiment was not confined to policy rates. **Treasury yields—which move inversely to price—fell across the curve**, with 2-year bond yields dropping nearly 30 basis points in the first three days of this week. The 30-year bond saw the biggest price improvements with gains of nearly 10% so far in November. In addition to the prospects for lower policy rates, **we believe bond markets were reacting to data showing a potential slowdown in domestic economic growth**, a condition that is generally good for fixed income. Anecdotal reports in the Fed's November Beige Book—a qualitative survey of economic conditions in the U.S.—were consistent with a softening economy, as were leading economic indicators released during the month. The picture was not uniform, however, as multiple regions continue to report tight labor markets and relatively strong consumer credit.

**Investors position for more aggressive rate cuts; futures imply high probability of 4% by January 2025**




Source - RBC Wealth Management, Bloomberg; data as of 11/29/23

- **The combination of lower rates and potentially slower growth was a major headwind for the dollar**. The U.S. Dollar Index (DXY)—a roughly trade-weighted measure of the greenback against other major currencies—is down approximately 4% in November. Even with the recent step back in value, the dollar remains well above both pre-pandemic and longer-term average levels versus major currencies.

## CANADA

Josh Nye & Luis Castillo – Toronto

- **Canada's economy avoids technical recession**. Canadian Q3 GDP growth was softer than expected, declining at a 1.1% annualized pace compared with a flash estimate that was closer to flat. However, that disappointment was offset by a substantial upward revision to Q2 growth with the economy now estimated by Statistics Canada to have expanded at a 1.4% annualized pace rather than contracting slightly. And the economy carried some momentum into Q4 with October's flash estimate pointing to a healthy 0.2% monthly increase. While it looks like Canada's economy will avoid a recession in 2023, growth has softened enough for the market to expect rate cuts by the Bank of Canada in H1 2024.

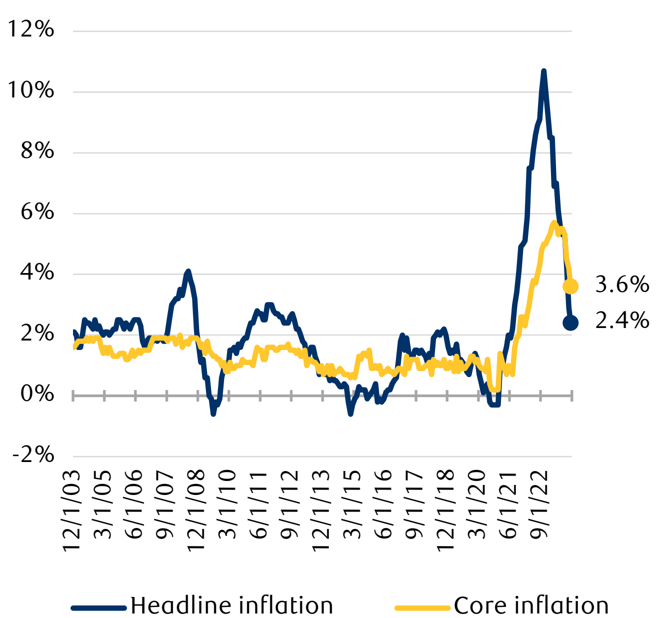
- **Risk-on in Canadian fixed income**. After widening over much of the past three months, Canadian investment-grade corporate credit spreads (the additional compensation demanded by investors for the risk of default in corporate credit) shrank in November. The spreads have returned to near their year-to-date lows, as markets ignore what could potentially be a difficult refinancing environment in the coming years, in favor of strong fundamentals today. In addition, market anticipation of sooner-than-expected rate cuts leading to a less restrictive operating environment has also supported spreads as investor sentiment towards riskier assets improves. However, we remain cautious; in our view, the potential for credit deterioration ahead is not to be taken lightly, as weakening economic momentum and a tougher refinancing environment begin to take a bite out of corporate profitability. In other words, the real corporate impact of tighter financial conditions is yet to be felt.

## EUROPE

Frédérique Carrier – London

- **Geert Wilders' far-right Freedom Party won the most votes in the Netherlands general elections**, securing 37 seats in the 150-seat Parliament. To take power, Wilders will need to form a coalition with three other parties. Centre-right parties have been unwilling to join forces with him in the past, though some are reviewing their stance given the extent of the Freedom Party's victory.
- Wilders faces many challenges, having never served in a ministerial position, nor taken part in the rigorous negotiations necessary to form a coalition government. His hallmarks have been strong criticism of minority and immigrant communities, and of the European Union, although more recently he has played down these stances. During his victory speech, Wilders stated he intends to honor the constitutional principles of the Dutch state, signaling that he may be less intransigent as he opens talks with potential coalition partners.
- **A Wilders government, if successfully formed, could have several implications for the EU**, including stalling progress on migration and asylum issues as well as complicating support for Ukrainian weapons supplies and EU membership. Should his victory herald a wider move to the right at the EU level, the bloc's climate policies may be vulnerable.
- **Eurozone inflation declined in November with both headline and core numbers coming in much lower than consensus expectations, indicating a continued improvement over previous periods**. Headline inflation fell to 2.4% y/y in November while core inflation (i.e., inflation excluding energy and food prices) declined to 3.6% y/y. The European Central Bank (ECB) may not want to claim victory quite yet, and remains concerned about wage growth and a potential increase in energy prices, though it should find these results very encouraging. With the effects of higher interest rates still working their way through the economy, the market is now expecting rate cuts as early as spring 2024.

### Inflation almost tamed in the eurozone




Source - RBC Wealth Management, Bloomberg; monthly data through 11/30/23

## ASIA PACIFIC

Emily Li – Hong Kong

- **Chinese authorities are intensifying their efforts to resolve the crisis in the country's real estate sector** by exerting significant pressure on banks to address a funding gap of approximately US$466 billion. This funding is necessary to stabilize the industry and to support the completion of unfinished apartment projects. Bloomberg, citing people familiar with the matter, reported that policymakers are finalizing a list of 50 developers who will be eligible for financial support, which is likely to include Country Garden and Sino-Ocean Group. We believe this shift in approach reflects a willingness to assist distressed builders.
- **Rising corporate payouts and a favorable tax environment for individual investors should enhance the attractiveness of dividend stocks in Japan, in our view**. The broader category of value stocks in Japan has benefited from global institutional investors' renewed interest, long-awaited inflationary impulses, and monetary policy decisions over the past three years; we think the increased focus on dividends may provide support for high-yielding shares, even as some of the macro factors begin to diminish. Although dividend stocks and value stocks have historically moved in tandem, there are indications of a shift. Many companies significantly increased their dividend payments during the most recent earnings season, largely influenced by the Tokyo Stock Exchange's efforts to enhance valuations.
- **The first Asian exchange-traded fund (ETF) tracking Saudi Arabian shares debuted in Hong Kong on Nov. 29**, representing the largest ETF of its kind to be traded in the city this year. This development highlights the collaborative efforts of the Middle Eastern nation and the Asian financial hub to strengthen their relationship. The CSOP Saudi Arabia ETF, based in Hong Kong, is the first of its kind in Asia to concentrate on shares listed on the Riyadh stock exchange. With over US$1 billion in assets, it boasts the sovereign fund of Saudi Arabia as one of its major investors.

# MARKET Scorecard

| Equities (local currency) | Level | MTD | YTD | 1 yr | 2 yr |
|---|---|---|---|---|---|
| S&P 500 | 4,550.58 | 8.5% | 18.5% | 15.0% | -2.2% |
| Dow Industrials (DJIA) | 35,430.42 | 7.2% | 6.9% | 4.7% | 0.8% |
| Nasdaq | 14,258.49 | 11.0% | 36.2% | 29.8% | -9.7% |
| Russell 2000 | 1,803.81 | 8.5% | 2.4% | -1.8% | -19.5% |
| S&P/TSX Comp | 20,116.20 | 6.6% | 3.8% | -0.8% | -4.9% |
| FTSE All-Share | 4,047.89 | 2.4% | -0.7% | -1.6% | -0.2% |
| STOXX Europe 600 | 459.10 | 5.9% | 8.1% | 5.0% | -1.7% |
| EURO STOXX 50 | 4,370.53 | 7.6% | 15.2% | 11.1% | 6.4% |
| Hang Seng | 16,993.44 | -0.7% | -14.1% | -6.7% | -28.8% |
| Shanghai Comp | 3,021.69 | 0.1% | -2.2% | -4.1% | -15.2% |
| Nikkei 225 | 33,321.22 | 8.0% | 27.7% | 18.9% | 17.8% |
| India Sensex | 66,901.91 | 4.7% | 10.0% | 6.7% | 16.8% |
| Singapore Straits Times | 3,084.70 | 0.6% | -5.1% | -5.8% | -1.1% |
| Brazil Ibovespa | 126,165.64 | 11.5% | 15.0% | 13.8% | 22.7% |
| Mexican Bolsa IPC | 52,792.18 | 7.6% | 8.9% | 5.2% | 6.0% |
| **Gov't bonds (bps change)** | **Yield** | **MTD** | **YTD** | **1 yr** | **2 yr** |
| U.S. 10-Yr Treasury | 4.253% | -67.7 | 37.9 | 50.9 | 275.5 |
| Canada 10-Yr | 3.507% | -55.7 | 20.7 | 51.0 | 189.0 |
| UK 10-Yr | 4.096% | -41.6 | 42.4 | 99.6 | 323.5 |
| Germany 10-Yr | 2.432% | -37.4 | -13.9 | 51.0 | 274.9 |
| **Fixed income (returns)** | **Yield** | **MTD** | **YTD** | **1 yr** | **2 yr** |
| U.S. Aggregate | 5.08% | 4.3% | 1.5% | 1.6% | -11.7% |
| U.S. Investment-Grade Corp | 5.66% | 5.6% | 3.6% | 3.9% | -12.4% |
| U.S. High-Yield Corp | 8.56% | 4.0% | 8.8% | 8.7% | -1.7% |
| **Commodities (USD)** | **Price** | **MTD** | **YTD** | **1 yr** | **2 yr** |
| Gold (spot $/oz) | 2,044.42 | 3.1% | 12.1% | 16.8% | 14.6% |
| Silver (spot $/oz) | 25.02 | 9.5% | 4.5% | 17.7% | 9.3% |
| Copper ($/metric ton) | 8,387.75 | 4.5% | 0.3% | 4.4% | -13.2% |
| Oil (WTI spot/bbl) | 77.86 | -3.9% | -3.0% | -0.4% | 11.3% |
| Oil (Brent spot/bbl) | 82.85 | -5.2% | -3.6% | -0.2% | 12.8% |
| Natural Gas ($/mmBtu) | 2.79 | -21.8% | -37.6% | -61.4% | -42.4% |
| **Currencies** | **Rate** | **MTD** | **YTD** | **1 yr** | **2 yr** |
| U.S. Dollar Index | 102.8340 | -3.6% | -0.7% | -3.7% | 6.7% |
| CAD/USD | 0.7361 | 2.1% | -0.2% | 0.0% | -6.2% |
| USD/CAD | 1.3585 | -2.1% | 0.2% | 0.0% | 6.6% |
| EUR/USD | 1.0973 | 3.8% | 2.5% | 6.2% | -2.8% |
| GBP/USD | 1.2696 | 4.5% | 5.1% | 6.2% | -4.6% |
| AUD/USD | 0.6618 | 4.4% | -2.9% | -1.0% | -7.3% |
| USD/JPY | 147.2600 | -2.9% | 12.3% | 6.2% | 29.7% |
| EUR/JPY | 161.5800 | 0.7% | 15.1% | 12.8% | 26.0% |
| EUR/GBP | 0.8643 | -0.7% | -2.4% | 0.0% | 1.9% |
| EUR/CHF | 0.9586 | -0.4% | -3.1% | -2.7% | -8.0% |
| USD/SGD | 1.3331 | -2.7% | -0.5% | -2.9% | -2.6% |
| USD/CNY | 7.1262 | -2.6% | 3.3% | -0.5% | 11.6% |
| USD/MXN | 17.2831 | -4.2% | -11.4% | -10.1% | -20.3% |
| USD/BRL | 4.9060 | -2.6% | -7.1% | -7.2% | -12.5% |

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Tuesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

Examples of how to interpret currency data: CAD/USD 0.73 means 1 Canadian dollar will buy 0.73 U.S. dollar. CAD/USD -0.2% return means the Canadian dollar fell 0.2% vs. the U.S. dollar year to date. USD/JPY 147.26 means 1 U.S. dollar will buy 147.26 yen. USD/JPY 12.3% return means the U.S. dollar rose 12.3% vs. the yen year to date.

Source - Bloomberg; data as of 11/29/23

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As of September 30, 2023

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|---|---|---|---|---|
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| Hold [Sector Perform] | 590 | 40.27 | 148 | 25.08 |
| Sell [Underperform] | 55 | 3.75 | 5 | 9.09 |

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