China: The long march to reform

The drawn-out reform of sprawling state-owned enterprises is accelerating. SOE reform will be at the forefront of President Xi’s second term in office, with important implications for China’s equity markets and the economy.

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While China may have been out of sight lately, it shouldn't be out of mind with the reform of state-owned enterprises starting to rev up. This complex process will demand heavy lifting from the authorities, and investors should be watching to see how the makeover takes shape.

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Investor bias often gets in the way of smart investing. So it's important to check your emotions at the door because letting them rule your investment decisions can be hazardous to your wealth.

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With the global economy forging ahead on the back of accommodative monetary policy, healthy banks, and upbeat consumers, it's difficult to imagine it rolling over into a downturn anytime soon. But it's always important to be heedful of the conditions that could choke off growth and to acknowledge them when they appear on the scene.

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Central bank convergence: Patience is the word

As central banks remove extraordinary stimulus, investors shouldn't leap several steps ahead and think a tightening era is upon us. Instead, central bankers are simply getting policy back to normal and they will nurture growth through a gradual, drawn-out process.

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All values in U.S. dollars and priced as of market close, September 29, 2017, unless otherwise stated.
RBC’s investment stance

Equities
- The global equity market continued to push higher as favorable economic fundamentals solidified and major central banks affirmed they will move toward normalizing monetary policies. For the first time since the Great Recession, most developed economies are in the midst of a synchronized, durable upswing, with the exception of the U.K. Indicators point toward the global and U.S. economic expansions stretching beyond our 12-month horizon.

- In the meantime, corporate revenues, earnings, and estimates are all rising, taking the sting out of price-to-earnings multiples that are no longer compellingly cheap. “Optimistic, invested, and vigilant” sums up our view. We would maintain a moderately Overweight commitment to global equities. Among developed markets, we favor an Overweight position in Europe and Market Weight exposure to the U.S., Canada, and Japan.

Fixed Income
- Major central banks have clearly communicated that the days of extraordinary monetary stimulus are in the rearview mirror. While we think this is an important shift following years of ultra-loose policies, guidance from each bank suggests the move toward interest rate normalization will unfold gradually. Central banks will be dealing with similar challenges—below-average economic growth, low inflation, low productivity, and shifting demographics—which, in our view, ensures policy normalization will unfold over many years. Their patient moves will be done to normalize, not tighten, monetary policy.

- We continue to believe the current environment provides investors a window to de-risk and diversify fixed income portfolios. While there are opportunities in the market, including in the credit sector, we advise patience and selectivity.

Views explanation
(+/=/−) represents the Global Portfolio Advisory Committee’s (GPAC) view over a 12-month investment time horizon.

+ Overweight implies the potential for better-than-average performance for the asset class or for the region relative to other asset classes or regions.

= Market Weight implies the potential for average performance for the asset class or for the region relative to other asset classes or regions.

− Underweight implies the potential for below-average performance for the asset class or for the region relative to other asset classes or regions.
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The 19th Congress of China’s Communist Party will be held October 18–25. This major political event held every five years will see President Xi Jinping consolidate his power heading into the second half of his 10-year term. China watchers will be looking for important economic policy messages, especially ones focused on any acceleration in the reform of state-owned enterprises and the associated reining in of the growth in corporate debt. Market calm prevails at present. The heads of China’s brokerage firms have been told not to go on holiday during the Congress.

What have investors been focused on for the past year? Not China. The mercurial U.S. presidency has sucked up both attention and column inches. Investors have been focused on the drama in the West Wing, pondering when and if any pro-market election promises become policy. China has been an afterthought. The country did pop up briefly on the market’s radar with respect to a possible trade war with the U.S., but that seemed to quickly recede after Xi Jinping’s visit to the U.S. in April. More recently, the North Korea issue has brought attention back to China, but equity markets have largely faded the risks.

Is no news good news?

For many investors, no news from China has been good news. The last time global equity markets corrected, at the start of 2016, China was in the crosshairs. Global equities retreated by 13%, but the Shanghai Composite fell by almost twice as much, 25%, in a matter of weeks.

At that time, some saw this severe selloff as evidence of a failing Chinese economy. In reality, it was more a technical selloff from a hugely overbought peak

Leading economic indicators for China

The Non-Manufacturing PMI (i.e., services), the larger part of the economy has been steady. The Manufacturing PMI has slowly, but steadily, improved.

Source - RBC Wealth Management, Bloomberg; data through 8/31/17
though there were red flags that gave credence to the broken-economy thesis: major capital outflows, declining foreign exchange (FX) reserves, and currency devaluation.

Capital outflows, estimated at over $100B per month at one point in late 2015, have moderated significantly, partly in response to a raft of measures to stop money from leaving the country. Reserves have risen for seven consecutive months, and while the currency did weaken by 13% over three years (mostly due to broad dollar strength in 2016), it has regained about a third of that back so far in 2017 and is now within 6% of where it was prior to the August 2015 “mini-devaluation.”

Once again, the Chinese authorities have demonstrated their ability to address economic issues producing losses for speculators and some hedge funds in the process. However, they face an acid test over the next few years as they tackle the large buildup in corporate debt.

China total debt breakdown

The bulk of Chinese economic data has been reasonably steady for a while. Leading economic indicators have been stable. Years of producer price deflation ended, helping to boost industrial profits. Renewed strength in parts of China’s complex property market has been met with targeted, local measures rather than the sledgehammer of national policy used in the prior tightening cycle. However, economic data did soften a bit over the summer and that trend may persist.

Preparing for a transition

The 19th Party Congress will be held October 18–25. This is the major meeting of China’s political elite held every five years. The equity market has historically been well behaved going into the Congress but performance thereafter varies.

The Party Congress, with over 2,000 members, is a political event centered on selection of members of the Central Committee (several hundred members), Politburo (25 members), and the all-powerful Politburo Standing Committee (currently seven members). A large turnover in personnel is common. This year, five members of the seven-member Standing Committee may retire, marking major changes at the top. It is also a chance for outsiders to get their first view of potential candidates for president in 2022.
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The national delegates elect the Central Committee. The Central Committee elects the Politburo, Standing Committee, and the General Secretary.

While a political event, President Xi’s Political Report will most likely cover important aspects of economic policy:

- The continued shift to a slower, stable pace of growth;
- Dealing with systemic risks including those in the Financials sector (e.g., debt);
- Promoting Xi’s hallmark “One Belt, One Road” strategy for building pan-Asian infrastructure ties and trade; and, importantly,
- The continuation of supply-side reform, of which state-owned enterprise (SOE) reform is a key feature.

A generation of SOE reform …

Many countries around the world have SOEs of one sort or another, yet they are most commonly associated with China due to its size and political structure. And while China has not been the focus of many investors over the past year, SOE reform has been gathering pace, evidenced by several megadeals. Around 50% of the market capitalization of a prominent equity index, MSCI China, is in SOEs. They dominate the weightings in most sectors, such as Energy, Financials, Industrials, Materials, Telecom, and Utilities.

SOE’s dominance in the index is not necessarily reflected in the economy as a whole. For example, the number of private firms dwarfs the number of SOEs in China; the vast majority of people work for private firms, not SOEs; SOEs hold a minority, albeit still a very large amount, of corporate assets these days; and the fastest growing, new economy sectors, such as e-commerce, have very few SOEs. This dislocation between the composition of the Chinese equity market and that of
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SOE reform has been an ongoing process over at least the past 20 years, but under President Xi, the authorities have put their foot on the gas pedal.

the corporate landscape is arguably the key reason that the path of Chinese equity indexes often seems to be unrelated to broader economic performance.

SOE reform is not new in China. It has been an ongoing process over at least the past 20 years. But under President Xi, the authorities have put their foot on the gas pedal and we expect that to continue in the second half of his tenure. There are several reasons for the acceleration.

... Has further to run

First, and simply, the current round of SOE reform took shape in 2013 at the start of Xi’s turn in power. This has generated pressure to show meaningful results, with that pressure increasing as the 2017 Party Congress has approached.

Second, and similar to SOEs outside China, state enterprises remain less efficient than private enterprises. Efficiency ratios have actually been getting worse partly due to persistent overcapacity in certain industries while some SOE managers may prioritize the firm’s size over its profitability. As a result, return on equity was a lowly 5.2% for SOEs in 2016. The combination of declining efficiency and profitability together with increasing debt is clearly unsustainable.

Third, there is open acknowledgement in China of the high growth rate in debt since the financial crisis and a new focus on “financial deleveraging.” In China it is the growth in corporate debt which stands out. And SOEs have accounted for most of it. SOE debt is approximately $13T or a crippling 120% of GDP. Total corporate debt is around 170% of GDP. Thus, SOEs account for 70% of total corporate debt, despite being far fewer in number than private enterprises and somewhat smaller in terms of assets. So-called “mixed-ownership reform” whereby new equity capital is attracted to SOEs has been identified as a key way to reduce leverage.

Committed to the task

SOE reform is no easy task. Some, such as the big banks, the big three energy companies, and the big three telecom companies, are critically important to the workings of the broad economy. Vested interests and political ramifications must also be considered. Also, big SOEs often employ particularly large numbers of people. In short, there is no simple solution, or magic bullet, for reform. Also, the degree of reform required may differ among industries and firms.

Strategies to date include mergers to reduce competition, increase operating efficiency, and create national champions; mixed-ownership to improve corporate governance, introduce private capital, and promote innovation; and reduction of excessive capacity. These strategies may have additional, important benefits: for example, improving operational performance by combining two SOEs will help to manage debt burdens. Recent examples of corporate activity in the pursuit of SOE reforms can be found on the following page.
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Recent examples of corporate activity to enhance reforms

- **Upstream/downstream merger**: In August, Shenhua Group, China’s largest coal producer, and Guodian Group, China’s second-largest power producer, announced a merger to form the State Energy Investment Co. Ltd. Unlike previous mergers of companies in the same industry, this merger is between companies that are in interrelated upstream and downstream businesses. Most of China’s power is derived from burning coal. Coal prices in China are market-driven while electricity prices are largely controlled by the government. This means power plants cannot pass volatile coal prices on to customers. When coal prices rallied strongly in the first half of 2017, profits of coal enterprises surged nearly 2,000% (2016 was a bad year), while earnings for the five largest listed power companies dropped by 70% on average. The new company will have greater control over the entire value chain.

- **Mixed-ownership reform**: The National Development and Reform Commission approved nine SOEs to be the first batch of reform pilots at the start of 2017; 10 more were approved recently as the second batch. In August, China Unicom, China’s second-largest wireless carrier and a famous SOE, became the first major SOE to introduce private capital at the group level. The company will sell a 35.2% stake of its mainland China-listed shares to 14 strategic investors, including the four largest Chinese internet companies. Additionally, the reform plan also includes an employee incentive plan, granting 2.7% shares to core staff. Management believes the reform will better align employees’ interests with those of investors.

- **Creation of national champions and reduction of competition**: China North Railway and China South Railway, the world’s two largest train makers, agreed to merge in 2014. The purpose was to avoid competition in overseas bidding and give them stronger pricing power.

- **Creation of national champions and reduction of excess capacity**: The Baoshan Iron & Steel and Wuhan Steel merger in 2016 created China’s largest steel company and the second largest in the world with over $100B in assets. Wuhan Steel had been expanding aggressively before the merger and got into trouble in a market downturn. In 2015, the company posted a net loss of RMB 7.5B with a total debt ratio over 70%. But if part of the goal was to reduce excess capacity, why is China’s steel production presently at record high levels? This is an example of how major industry overhauls can take many years to unfold. Currently, China plans to raise the steel industry concentration by increasing the market share of the top 10 steel producers to over 60% by 2025 from 37% in 2014.

Source - RBC Wealth Management

Too early to tell
Reforming SOEs does not aim to get rid of them, nor does it mean mass privatizations. The government still emphasizes the important position of the state in key industries, which may lead to questions of how successful these reforms can be. But any reform that improves corporate governance and empowers
employees by incentivizing the creation of shareholder value will be well regarded by investors. It is too early to judge the long-term success or failure of SOE reform under the current administration, although we can clearly see progress being made.

It is likely the composition of China’s equity markets will continue to change, with the market capitalization of more profitable private enterprises increasing as they continue to outgrow their less efficient SOE peers. We believe the relatively new sectors of Technology, the internet, and Health Care all have long runways of growth ahead of them, boding well for index composition. China may have been out of sight lately, but it shouldn’t be out of mind. The 19th Party Congress later this month provides an ideal juncture for investors to refocus.

On the next page is an Appendix comparing the different compositions of China’s two stock exchanges, Shanghai and Shenzhen, that sheds light on China’s so-called two-speed economy as well as the excessive weighting to SOEs, particularly in the Shanghai Stock Exchange.
Appendix: The two-speed stock exchanges

The different histories of China’s two stock exchanges, Shanghai and Shenzhen, somewhat reflect the country’s “two-speed” economy. This is a simplistic classification that broadly separates China’s “old economy,” such as heavy industry, and its “new economy,” such as technology and health care. There is still a tendency to view China through the old economy lens (e.g., scrutinizing electricity demand) rather than the new economy lens (e.g., the growth in parcel delivery due to e-commerce). This narrative should be reframed, although the old economy performance and indicators are still vitally important.

The Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE) opened in 1990, yet they are already among the world’s largest exchanges. There are 3,385 companies listed with a combined market capitalization of $8.7T, second only to the U.S. Shanghai is $5.0T and Shenzhen is $3.7T. Yet their composition and characteristics differ markedly.

When China set up its stock market just 25 years ago, a major objective was to solve the financing problem of state-owned enterprises (SOEs). Unsurprisingly, most of the first listed companies were state-owned and Shanghai was the place to list. Today, the core of the Shanghai market, with 1,342 listed companies, remains large-cap SOEs, accounting for approximately 74% of the market capitalization.

Shenzhen, a city of approximately 10 million people just to the north of Hong Kong, was originally set up as one of China’s special economic zones and thus has a very active private sector. A number of China’s private enterprise giants began life and are headquartered in Shenzhen, including Tencent, Huawei, Ping An Insurance, and Vanke Property. More recently, there has been a wave of innovative start-ups listing in Shenzhen. In all, there are 2,039 companies listed.

SOEs account for only 30% of Shenzhen’s market capitalization. That figure should decline further due to the better growth in private firms and more private firms listing. The Shenzhen Exchange has been more supportive of small and medium-sized enterprises (SMEs) via the development of the Small-Mid-Enterprises Board (SME Board) and also the Growth Enterprise Market Board, more commonly
Outsized new economy growth points to significant pockets of largely unheralded expansion in China.

referred to as ChiNext. Consequently, the SME Board surpassed the Main Board in terms of both the number of listed companies and total market capitalization in 2015.

Sector allocations are quite different between Shanghai and Shenzhen. Financials, Industrials, and Energy are the biggest components of the Shanghai Composite Index, accounting for 29.6%, 18.3%, and 10.5%, respectively. PetroChina and Industrial and Commercial Bank of China (ICBC) alone account for nearly 9% of the index. By contrast, the top three sectors of the Shenzhen Composite Index are Industrials (21.5%), Technology (20.2%), and Consumer Discretionary (16%). For ChiNext, Technology companies account for almost 40% of the index.

Technology & innovation
After the Global Financial Crisis, China increased focus on the upgrading of its industrial base and on innovation. An important component of this was the establishment in 2009 of the ChiNext Board. Companies must be identified as innovative, growth enterprises in order to obtain approval for listing. There are 692 companies listed on the ChiNext Board with a total market capitalization of RMB 5.54T ($840B). The creation and growth of ChiNext has also helped activate China’s venture capital market. A significant minority of the world’s so-called “unicorns” (a start-up valued at over $1B) are from China, in fact second only to the U.S.

Slowing down or speeding up?
The deceleration of economic growth in China is by no means universal across industries. The new economy companies that dominate the ChiNext Board, from industries such as media, electronics, environmental protection, and logistics, posted revenue growth of 20%, 23%, 30%, and 34% in 2013, 2014, 2015, and 2016, respectively. ChiNext companies’ operating profits rose 30% in 2015 and 38% in 2016, powered by the Technology sector.

These outsized figures point to significant pockets of largely unheralded expansion in China. And they even show acceleration during a period when all the talk has been of the opposite. Revenue and earnings growth in 2016 were the highest in six years. Companies on the Shenzhen SME Board have also been posting growth that has diverged from the traditional narrative. Revenues grew by 17% in both 2015 and 2016, earnings by 11% in 2015 and 30% in 2016.

Before we all rush out to buy “new China” stocks, a note of caution on valuations. Rapid growth of these businesses is already captured in what investors pay for them. The SME and ChiNext Boards trade at price-to-earnings multiples of 44x and 54x, respectively (compared to 18.1x for the Shanghai Main Board).
Dealing with feeling: Understanding investor bias

No matter how rational or detached we’d like to think we are, the reality is that emotions often get the better of us. And when it comes to how we invest our money we have to be particularly attuned to our feelings in order to sidestep emotional traps. We look at ingrained biases that affect us as investors and how we can look past our emotions.

When it comes to making complex investment decisions, many people follow a series of simple rules of thumb that in many cases are based on deeply ingrained biases that lead to irrational decisions. While these biases might be useful in helping individuals cope with day-to-day choices, they can be unhelpful for achieving success in long-term activities such as investing. By gaining insight into investor behaviour, investors can be coached to understand their own biases and make better investment decisions.

This is the first in a series of articles exploring a behavioural finance topic that discusses some of the most common investment decision-making mistakes and provides practical tips for avoiding them.

We start the series this month with a focus on two of the most common investor biases: so-called “loss aversion” and “narrow framing.”

**Loss aversion**

Fear of losing is a much stronger driver of behaviour than the potential for gains.

Loss aversion is a central concept in behavioural finance. It is captured in the phrase “losses loom larger than gains” that was coined in the groundbreaking 1979 paper, *Prospect Theory: An Analysis of Decision under Risk*, by Nobel laureate Daniel Kahneman and the late Amos Tversky. Experiments by the authors revealed that the pain of losing is psychologically about twice as strong as the pleasure from gains.

It is this aversion to loss that can drive investors to make emotional, rather than rational, decisions.

The decision not to invest is an active decision made every day. The fears of having missed the boat with an investment opportunity or that markets are too stretched are common and understandable objections that investors make. When this happens, investors often decide to wait on the sidelines for the next opportunity rather than put their money to work in the market. So how can investors learn to look past their emotions?
Try the overnight test
Consider the following situation. As an investor, you are holding a stock that is
nursing a heavy loss but you just can't bring yourself to sell.

Try the overnight test. How would you react if the stock was sold overnight and
you woke up to cash in your bank account? Would you buy the stock back again?
This "overnight test" is effective in determining an investor's true attachment to an
investment.

This test can be applied just as equally to investors who are holding a large amount
of cash and are considering investing. If you woke up one morning to find stocks
instead of cash, how would you feel? Would you immediately sell the stocks to
rebuild your cash position?

Focus on the fundamentals
Investment managers often speak of how they focus on the fundamentals and
for good reason. Media speculation focuses on the noise, while fundamentals—
quantitative and qualitative data about companies or markets—act as signposts
for the direction of stocks and economies.

Buying a share of a business that has a proven track record of growing sales,
earnings, and dividends and which is able to reinvest retained earnings, on the
shareholder's behalf, at its internal rate of return, which is typically far higher than
the growth rate of the economy, tells you at least 95% of what you need to know.
News noise and the prospect for short-term fluctuations, too often the tail that
wags this dog, fade into irrelevance by comparison.

The fear of loss can push investors to sit in cash in the belief that because markets
have risen, they are certain to fall. It is true that markets do not travel upwards in a
straight line and can fall or pull back as well as rise. Knowing where the economy
is heading next is an important factor that allows investment decisions to be made
with confidence. Economic expansions tend to be good for corporate earnings and
stock prices, while recessions are unequivocally bad. Valuable indicators of which
phase the economy may be entering include consensus forecasts of economists,
central bank forecasts, and reliable leading indicator series.

Narrow framing
Focusing on short-term stock or market movements often creates a distorted view
of the true value of a company or equity index and deters investors from taking the
risks they are capable of taking.

There is a famous story told of Massachusetts Institute of Technology (MIT)
Professor Paul Samuelson, a Nobel laureate in Economic Sciences. He offered his
colleague a choice on a coin toss. If the coin landed on heads, his colleague would
receive $200, but if it landed on tails his colleague would have to pay $100.

His colleague rejected the proposition because the potential pain of losing $100
was not worth the potential pleasure of the $200 gain. Instead, the colleague came
up with a counteroffer, saying that, rather than doing it only once, he would be
willing to do it 100 times.

If he was not willing to try once, why would he be happy to try 100 times?
Understanding investor bias

Here’s “narrow framing” in an investment context. Imagine you have $10,000 to invest that is not required for the next five years. You are offered two funds whose performance is shown in the charts below. The chart on the left shows the month-by-month performance of an investment fund over the past five years. Meanwhile, the chart on the right shows the monthly equivalent returns for a fund in rolling five-year periods, from worst to best (e.g., a rolling five-year return for January 2012 would include returns for the period February 1, 2007 through January 31, 2012).

Experiments show that, based on the data in the charts, investors are more likely to pick the fund represented in the chart on the right. The prospect of steady positive returns from this chart is more appealing than the idea of very volatile monthly returns represented in the chart on the left.

It should not be a surprise, however, that the two charts are showing returns from the same fund. By taking a longer-term view of performance—widening the frame—and allowing the short-term ups and downs to average out, investors are more likely to accept a higher level of risk. Learning to ignore short-term, narrow moves and instead focusing on long-running trends can lead to a more successful investing experience.

So, going back to our MIT professors, why was Professor Samuelson’s colleague happy to flip the coin 100 times but not once? If everything depended on one coin flip then there would be a 50% chance he was going to lose $100. But over 100 flips there would likely be something in the neighbourhood of 50 heads and 50 tails and by agreeing to change the potential loss and gain to $1 and $2, respectively, then he would have to encounter 100 tails in a row to lose $100—a very, very unlikely outcome. Because of the $2 payout on heads versus just a $1 cost on tails, any result better than 33 heads out of 100 flips would earn him a profit. In other words, by “widening the frame” Professor Samuelson’s colleague improved his chances of earning a profit (or not losing) to 67% from 50%.

For more on this topic, we will publish additional “Dealing with feeling: Understanding investor bias” articles in the coming months in Global Insight.
Amidst the devastation of hurricanes, floods, wildfires, and earthquakes, the global economy keeps plodding along. In fact, “skipping” along might be a better descriptor. Purchasing Managers’ Indexes (PMIs) have been hitting fresh highs in some developed countries and holding at elevated levels in the rest. To be clear, this means that, on average, companies are seeing levels of new orders and current production sufficient to keep output expanding in the coming months. This pace of expansion has kept employment growing and the rate of unemployment falling across the developed world.

As surplus labour and other measures of excess capacity have diminished, the Fed’s commitment to “normalise” U.S. monetary policy has become more entrenched. The Bank of Canada has turned the corner onto the same road. The Bank of England has given markets “fair warning” of its intention to do the same. While a move to higher rates is nowhere in sight for the European Central Bank, the bank is expected to again reduce the scale of its bond-buying programme (QE) in the coming months. Despite the foregoing, central bank policies are a long way from “tight.” But, to borrow a phrase from RBC Global Asset Management Chief Economist Eric Lascelles—“peak money” is now behind us.

This has already been a long economic expansion by historical standards—33 quarters and counting for the U.S., 17 for Germany, and 33 for the U.K. That said, we see few if any reasons to imagine the global economy is going to roll over into a downturn anytime soon.

Optimistic, invested, and vigilant

In particular, monetary conditions remain accommodative, banks in the developed economies are for the most part healthy and strongly capitalised, while consumers and businesses are upbeat and confident. Weakening these strong underpinnings takes time—at least a year, probably two, perhaps longer.

In the meantime, corporate revenues, earnings, and estimates are all rising, taking the sting out of price-to-earnings multiples that are no longer compellingly cheap.

“Optimistic, invested, and vigilant” nicely sums up our investment stance today. We know what conditions would have to change in order to turn our recommended positioning aggressively defensive—chief among them the arrival of restrictive monetary conditions. Typically, the danger for investors is not in failing to see those economy/bull-market-killing conditions when they eventually arrive on the scene. Rather, it is the temptation to rationalise them away (“This time it’s different!”) in favour of wishing and hoping the good times will
continue; hence, our commitment to vigilance.

For a global portfolio we recommend a moderate Overweight commitment to equities. We have Market Weight positioning for most major developed markets with the exceptions of Europe where we are Overweight, and the U.K. at Underweight. All are unchanged from last month.

**Regional highlights**

**United States**

- With Washington’s fiscal deadlines pushed out and a tax cut proposal introduced, the S&P 500 powered ahead by 1.9% in September, a month that is historically the weakest of the year. The S&P 500, Dow, and NASDAQ climbed to new all-time highs.

- There has been enough good news about the economy to more than offset the negative impact of Hurricanes Harvey and Irma. We anticipate hurricane devastation will constrain Q3 GDP growth somewhat, followed by a reversal in Q4 and probably into early 2018.

- S&P 500 Q3 earnings have a lower bar to clear now that the consensus forecast has been ratcheted back to 6.2% y/y growth from 9.5% in April. The economy’s resilience will likely push the final growth rate above the consensus estimate in spite of hurricane damage.

- Health Care remains a timely sector idea. We believe pharmaceutical and biotech pricing risks that cropped up during the presidential campaign are already factored into those groups. Price regulations should be tame and sensible over the next few years, and Health Care is inexpensive on absolute and relative bases. The sector trades at 17.7x the forward consensus price-to-earnings estimate versus the 18.2x average since 1990. The S&P 500 is the opposite—it trades at 19.3x the forward estimate versus the 16.0x average.

**Canada**

- We maintain a Market Weight recommendation on Canadian equities. We reduced our recommended allocation from Overweight in April, and see no reason to shift to a more aggressive stance at this point. We continue to monitor valuations as well as the outlook for the housing market, crude oil, and U.S. growth, among other factors, in regards to whether a change in our recommendation is warranted.

### 2017 Dow Industrials returns outpace historical averages

<table>
<thead>
<tr>
<th>Month</th>
<th>2017 Return</th>
<th>Historical Avg. Return since 1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>August</td>
<td>0.3%</td>
<td>-1.3%</td>
</tr>
<tr>
<td>September</td>
<td>2.1%</td>
<td>-0.6%</td>
</tr>
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The 2017 summer equity markets successfully navigated the oft-challenging August and September months.
Global equity

• The valuation of the S&P/TSX relative to the S&P 500 has reverted to the discounted levels of early 2016. However, the Canadian market is not unique in that respect as the S&P 500 is the highest-valued developed market equity benchmark on a price-to-earnings basis.

• The Southern Ontario housing market has cooled considerably from the torrid gains experienced earlier this year. While fears of a correction appear overblown in the face of supportive employment and migration trends, there is still cause to be wary in light of stretched affordability and higher interest rates.

• We believe renewed momentum in U.S. crude inventory draws could support oil prices in the short term. However, we maintain a cautious medium-term view as we anticipate a rally of North American crude prices into the mid-US$50/barrel range would prompt increased production amongst U.S. shale producers.

• NAFTA renegotiations remain a lingering risk for Canadian equities with key issues to be considered including the amount of North American content required for duty-free trade and the conflict resolution process.

Continental Europe & U.K.

• With economic data continuing to be healthy, political risk largely behind us for now, and valuations which leave room for upside, we maintain our Overweight stance on European equities. We see the recently announced labour reforms in France as a having the potential to underpin growth in the medium term by improving the prospects of the region's second-largest economy.

• We recognise that a further sustained appreciation of the euro would be a headwind to corporate earnings, though the currency's ascent seems overdone to us in the short term. We maintain our preference for companies exposed to the domestic economy.

• Well-capitalised banks in particular should continue to benefit from Europe's recovery, where a return of loan growth is helping consensus earnings estimates to be revised upwards, while valuations remain below their long-term average.

• As for the U.K., the tone of the Brexit discussion has softened. Prime European consumer loan growth and bank valuations

<table>
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<tr>
<th>European consumer loan growth</th>
<th>European bank forward P/E ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013  2014  2015  2016  2017</td>
<td></td>
</tr>
<tr>
<td>11.8x  12.4x  10.8x  12.2x  11.6x</td>
<td></td>
</tr>
</tbody>
</table>

Loan growth has returned to Europe and reasonably valued banks stand to benefit.

Source - RBC Wealth Management, Bloomberg; data through 9/29/17
Minister Theresa May is now seeking a transitional deal whereby the post-Brexit U.K. would have access to the single market on current terms for some two years. While offering some respite in the short term by avoiding the so-called cliff edge, the lack of clarity regarding trade arrangements beyond that remains a key concern for businesses. We continue to expect the domestic economy to suffer and prefer export-orientated companies.

Asia
• The MSCI AC Asia Pacific Index continues to have a good year, up nearly 21%. A number of Asian indexes are at all-time highs. A period of consolidation is quite possible, especially following some softer economic data from China over the summer. Asian equities in general have ignored the escalating dialogue over North Korea.

• Japanese Prime Minister Shinzo Abe, in power for five years, has announced a snap election in October. His popularity ratings, which had sunk to particularly low levels following several domestic incidents, have rebounded strongly over the past two months. Japanese equity performance has been good. The TOPIX Index is close to its cycle-high of 2015 and at a new high when measured in dollars. We expect further gains in equities based on decent prospects for earnings growth.

• We are Market Weight for Greater China stocks. Earnings growth has been strong this year, but may moderate with the economy. Valuations, especially for A-shares, are not attractive. We expect Chinese equity markets to be well behaved heading into the 19th Party Congress later in October. Thereafter, historical performance has varied quite a bit.

The TOPIX lags the earnings outlook, providing room for upside to stocks.
September proved to be a busy month for central bankers, and regardless of whether policy action was taken, the message is clear that they are ready to put the days of extraordinary policy stimulus behind them. We think these are important shifts, which have visions of higher rates dancing in some investors’ heads. To us they are overly concerned, as policy guidance from each bank suggests new policy measures will unfold only gradually.

The Bank of Canada (BoC) appears to be heading toward a third rate hike in 2017 (in December), the Bank of England (BoE) is signaling it could hike rates before year end, and the U.S. Federal Reserve affirmed last month its plans for a balance sheet tapering and a December rate hike. European Central Bank (ECB) officials are expected this month to unveil 2018 tapering plans for their bond-buying program (QE).

Taken at face value, the BoC and BoE appear to be playing catch-up with the Fed, but upon further investigation both are removing extra accommodation put in place to cushion the blow from economic and/or political events. Once completed, they will likely begin a holding pattern for future hikes.

Improving global economic fundamentals will continue to embolden central banks, but it’s important in our view to remember these patient and gradual policy moves are done to normalize, not tighten, monetary policy. Central

Central bank convergence: Patience is the word

Fixed income views

<table>
<thead>
<tr>
<th>Region</th>
<th>Gov’t Bonds</th>
<th>Corp. Credit</th>
<th>Duration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global</td>
<td>–</td>
<td>+</td>
<td>5–7 yr</td>
</tr>
<tr>
<td>United States</td>
<td>–</td>
<td>+</td>
<td>5–7 yr</td>
</tr>
<tr>
<td>Canada</td>
<td>–</td>
<td>=</td>
<td>3–5 yr</td>
</tr>
<tr>
<td>Continental Europe</td>
<td>=</td>
<td>+</td>
<td>5–7 yr</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>–</td>
<td>=</td>
<td>5–7 yr</td>
</tr>
</tbody>
</table>

+ Overweight = Market Weight – Underweight

Source - RBC Wealth Management

Sovereign yield curves

Source - Bloomberg

banks will all be dealing with similar challenges—slow economic growth, low inflation, low productivity, and shifting demographics—which, in our view, ensures central bank policy convergence will unfold over many years.

Regional highlights

United States

• The Fed formally announced its plans to begin scaling back its $4.5T balance sheet. Beginning this month, the Fed will cap the amount of maturing Treasuries and mortgage-
backed securities that will not be reinvested at $10B. This will rise by $10B quarterly until October 2018, when a terminal monthly level of $50B will be reached.

• Markets barely flinched, and for good reason, in our view. In light of the balance sheet size, the reductions are modest. We expect minimal market impact—and maintain our subdued yield outlook—particularly with global central banks expected to continue providing extraordinary liquidity for years to come, albeit at a reduced level.

• Perhaps the bigger news from the September Fed meeting was that officials still forecast another rate hike this year, and maintained their view of three further hikes in 2018, despite also forecasting a slightly more benign inflationary backdrop. That pace remains aggressive to what the market is priced for—just two hikes by the end of 2018—but it’s clear that inflation data will dictate whether the Fed can deliver further rate hikes.

• At odds with a slightly more-hawkish Fed outlook, one of the few fixed income sectors that has seen price declines in recent months is in hybrid-preferred securities, specifically in those that reset to floating coupons within five years. We would expect this structure to perform well in a faster rate hike environment, so this modest pullback might offer investors looking for low-duration income an attractive entry point.

• The ratio of 5-year muni yields to Treasury yields fell to just 65% in September, barely more than the 15-year low of 63% in 2009. We again stress how rich the front end of the muni curve is and that extension swaps to the long end—where 30-year munis trading at a near-average at 102% of Treasuries—continue to look compelling.

Canada
• The Government of Canada curve flattened further through September after the Bank of Canada (BoC) somewhat surprisingly raised the overnight lending rate by an additional 25 basis points to 1.00%. The move caused short-term bond yields to shift higher alongside expectations for future interest rate hikes although the longer end of the curve continues to be hampered by a lack of inflation expectations and low global government bond yields. We think the BoC will be slower at raising the overnight lending rate compared to previous hiking cycles given a number of headwinds facing the economy such as elevated household debt, tricky NAFTA negotiations, as well as a potential U.S. tax reform which could make the Canadian economy less competitive. This keeps us constructive on interest rate risk within bond ladders. We note that a flatter curve reduces the appeal of extension trades and our current attention is on short-to-intermediate maturity bonds.

• Investment-grade corporate bond spreads continue to hover around their tightest levels in three years which keeps us cautious on taking too much credit risk. Our long-lasting call to upgrade credit quality within portfolios remains in place, and we recommend investors diversify geographic exposure by looking to the ever-growing Maple bond market, where possible.

• The positive correlation between interest rates and preferred shares was absent in September. Although
the stagnant prices are a reflection of the significant price appreciation that the asset class has experienced over the past 18 months, we think this creates an opportunity for investors who are under-invested, as well as being risk tolerant, to modestly increase an allocation to preferred shares.

Continental Europe & U.K.
• The European Central Bank (ECB) meeting failed to reveal details on how it intends to continue its bond purchasing programme into 2018. Bond purchases will be kept at €60B per month until the year end and deposit rates maintained at -0.4%.

• ECB President Mario Draghi noted that the strength of the euro needs to be “monitored” closely as inflation forecasts were downgraded for the second consecutive time, from 1.3% to 1.2% and 1.6% to 1.5% for 2018 and 2019, respectively. Both forecasts are materially below the 2% target.

• We expect the ECB to continue its accommodative posturing while the region’s growth remains healthy but inflation disappoints. Our view is that interest rates will remain on hold for a long time and that Bund yields will be anchored in the near term while peripheral spreads will narrow.

• The minutes from the Bank of England’s September meeting suggested a majority of Monetary Policy Committee members believed that “some withdrawal of monetary stimulus was likely to be appropriate over the coming months.” This hawkish tone forced the Gilt yield curve steeper as markets priced in the possibility of tighter monetary policy.

• We now expect a rate hike of 25 basis points in the U.K. this November. It does not reflect a change in our assessment of the U.K. economy, but rather a recognition of the labour market tightening, with unemployment falling to its lowest level since 1975 at 4.3%. We don’t think this one rate hike could turn into a series during the course of next year, given the challenges faced by the economy as the U.K. divorces from the EU.

![Gilt yield curve](source - RBC Wealth Management, Bloomberg; data as of 9/25/17)

The Gilt yield curve steepened in September in response to the BoE’s more hawkish tone.
Red zones

Copper’s reputation as a “leading indicator” for global economic growth is burnished in large part by its widespread applications across many sectors of the world economy, from construction to electronics. The “red metal” has staged an impressive rally this year, with spot prices hitting a three-year high by the end of August before reversing course in September. While global growth remains robust, we believe copper prices have overshot supply-demand fundamentals, leaving it vulnerable to further downside pressure in the near term.

There are three notable drivers for the copper price rise this year. First, the Chinese economy, which accounts for nearly half of global copper consumption, recorded faster-than-expected GDP growth and resilient industrial production during the first half of the year. Declining inventory levels and supply disruptions at major copper mines also played a crucial role in driving copper prices higher. Finally, a pullback in the U.S. dollar helped to bolster sentiment toward most commodities.

Two of those drivers may be showing nascent signs of reversing course. The U.S. dollar has bounced off its year-to-date lows recorded in early September when the Federal Reserve reiterated its intention to lift short-term interest rates one more time before year end, and perhaps three times in 2018. Meanwhile, China missed analysts’ expectations on two measures of growth last month: factory output and fixed-asset investment. Chinese officials are also expected to tighten monetary conditions in an attempt to cool the overheated property sector, which could lead to less investment in infrastructure and dampen copper demand.

Despite potential near-term headwinds, we generally expect copper to strengthen longer term. Part of this is due to the electric car revolution, since copper is not only needed in battery-powered vehicles, but also in each charging station. There have also been expectations of tighter supply in upcoming years as capital expenditures by mining companies have dropped by over one-third since 2011. RBC Capital Markets forecasts the price of copper to reach $3.00/lb., but only in 2020 (from $2.75/lb. in 2018). A mild correction in copper prices seems likely in the near term, but we maintain a positive long-term outlook on favorable supply/demand dynamics.

Commodity forecasts

<table>
<thead>
<tr>
<th>Commodity</th>
<th>2017E</th>
<th>2018E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil (WTI $/bbl)</td>
<td>49.00</td>
<td>53.00</td>
</tr>
<tr>
<td>Natural Gas ($/mmBtu)</td>
<td>3.08</td>
<td>3.16</td>
</tr>
<tr>
<td>Gold ($/oz)</td>
<td>1,269</td>
<td>1,300</td>
</tr>
<tr>
<td>Copper ($/lb)</td>
<td>2.60</td>
<td>2.75</td>
</tr>
<tr>
<td>Corn ($/bu)</td>
<td>3.70</td>
<td>3.93</td>
</tr>
<tr>
<td>Wheat ($/bu)</td>
<td>4.45</td>
<td>4.73</td>
</tr>
</tbody>
</table>

Source - RBC Capital Markets forecasts (oil, natural gas, gold, and copper), Bloomberg consensus forecasts (corn and wheat)
Currencies

U.S. dollar: Building momentum
While September was a rocky month for the dollar, it managed to rally against most currencies in the developed world. Support was provided following the latest Federal Reserve meeting, where the rate setting committee held its expectation that a further rate hike will be delivered before the end of the year, and three more by the end of 2018. With the market still some way behind this expectation, we hold our constructive view for the dollar towards the end of the year.

Euro: Mixed messaging
Following months of continued strength, the single currency fell through September. While acknowledging its impact on inflation expectations, the ECB stopped short of explicitly talking down the currency following its very strong performance year to date. We still believe the inflation dynamics in the eurozone will force the ECB to remain accommodative for a very long time, keeping the euro undervalued in the medium to longer term.

British pound: Fading rally
The pound rallied strongly throughout September, as the Bank of England asserted that a rate hike may be necessary in the coming months. We accept that the probability of a hike in the near future has materially risen, given this change in tone, but our outlook for the U.K. economy, and the pound, remains unchanged; a continued squeeze on the consumer, disappointing trade growth, and uncertainties around Brexit keep us Underweight GBP.

Canadian dollar: Positive steps
The Bank of Canada demonstrated its drive towards higher short-term rates by delivering a hike at its September meeting—the market had only priced in 50% probability of such an outcome. RBC Capital Markets is expecting a further hike before the end of the year, and three more in 2018. While some retracement may be possible in the near term, given the sharp move higher, we are moving towards a more positive bias for the loonie in the months ahead.

Japanese yen: Seeing asset shift
The yen’s status as a safe haven adds volatility during recent times of geopolitical concern, but through the noise we still remain bullish. With early signs that domestic investors are shifting towards hedging foreign assets, a positive for the currency, we are still looking for the yen to head to 100 per USD in early 2018.

GBP carried higher as U.K. rate hike expectations build

Source - Bloomberg, RBC Wealth Management; data through 9/29/17

Jack Lodge
London, United Kingdom
jack.lodge@rbc.com

Currency forecasts

<table>
<thead>
<tr>
<th>Currency pair</th>
<th>Current rate Sep 2018</th>
<th>Forecast Sep 2018</th>
<th>Change*</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD Index</td>
<td>92.66</td>
<td>98.30</td>
<td>6%</td>
</tr>
<tr>
<td>CAD/USD</td>
<td>0.80</td>
<td>0.79</td>
<td>-1%</td>
</tr>
<tr>
<td>USD/CAD</td>
<td>1.24</td>
<td>1.26</td>
<td>2%</td>
</tr>
<tr>
<td>EUR/USD</td>
<td>1.18</td>
<td>1.08</td>
<td>-8%</td>
</tr>
<tr>
<td>GBP/USD</td>
<td>1.33</td>
<td>1.24</td>
<td>-7%</td>
</tr>
<tr>
<td>USD/CHF</td>
<td>0.96</td>
<td>1.08</td>
<td>13%</td>
</tr>
<tr>
<td>USD/JPY</td>
<td>112.51</td>
<td>104.00</td>
<td>-8%</td>
</tr>
<tr>
<td>AUD/USD</td>
<td>0.78</td>
<td>0.73</td>
<td>-6%</td>
</tr>
<tr>
<td>NZD/USD</td>
<td>0.72</td>
<td>0.69</td>
<td>-4%</td>
</tr>
<tr>
<td>EUR/JPY</td>
<td>132.92</td>
<td>112.00</td>
<td>-16%</td>
</tr>
<tr>
<td>EUR/GBP</td>
<td>0.92</td>
<td>0.87</td>
<td>-5%</td>
</tr>
<tr>
<td>EUR/CHF</td>
<td>1.14</td>
<td>1.17</td>
<td>3%</td>
</tr>
</tbody>
</table>

* Defined as the implied appreciation or depreciation of the first currency in the pair quote.
Examples of how to interpret data found in the Market Scorecard.
Source - RBC Capital Markets, Bloomberg

Despite short-term uplift, expect GBP weakness further ahead.
**Key forecasts**

**United States — Unwinding begins**
- FOMC announced beginning of balance sheet unwinding. Q2 GDP revised higher to 3.1%, fastest pace in 2 years. Inventory buildup boosting growth. Employment steady. Manufacturing data continues to strengthen. Housing data slows as low available supply drags on activity, pushing prices higher. Data beginning to be skewed by hurricanes.

**Canada — BoC hikes again**
- Bank of Canada surprised by raising rates again in September. Retail sales moderated to 0.2% over the month. GDP growth stalled to flat m/m. Hiring reaccelerated, pushing unemployment rate to lowest of recovery at 6.2%. Housing correcting at healthy pace. Headline inflation higher to 1.4% y/y, from 1.2% month prior.

**Eurozone — Slow and steady**
- Q2 economic growth stabilized at 2.3%, but low inflation persists. European Central Bank policy remains accommodative, asset purchases steady. Manufacturing activity continues to improve after early summer pause. Eurozone employment picture brightening. Retail sales retreated to 2.6% y/y from 3.1% prior.

**United Kingdom — Moving to tighten**
- Bank of England held rates steady in September, but with inflation surging back to 2.9% y/y, Governor Carney shifted to hawkish. Probability of a November hike surged to 73%. Real wages dipped further into negative territory as inflation outpaced average earnings despite 40-year low unemployment rate of 4.3%. Brexit negotiations continue to weigh on investment, and should keep any tightening gradual.

**China — Investment slowing**
- Capital expenditures over the first 8 months have risen just 7.8% y/y, slowest pace since 1999. Industrial production missed expectations, rising 10.1% y/y. Credit growth is slowing amid the government’s deleveraging efforts, which now must be balanced with moderating economic growth. But slower credit growth is a long-term positive that supports a more sustainable economic expansion.

**Japan — Inflation rising**
- Q2 GDP revised down to 0.6% q/q from 0.7% as business investment lagged, though personal consumption contributed the most to GDP since 2014. North Korea concerns strengthened the yen early on in the month on safe-haven demand, and could weigh on exports. CPI inflation hit 0.7%, 2-year high, though the Bank of Japan maintained its unprecedented stimulus measures.

---

**Source**
- RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee
<table>
<thead>
<tr>
<th>Index (local currency)</th>
<th>Level</th>
<th>1 month</th>
<th>YTD</th>
<th>12 month</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500</td>
<td>2,519.36</td>
<td>1.9%</td>
<td>12.5%</td>
<td>16.2%</td>
</tr>
<tr>
<td>Dow Industrials (DJIA)</td>
<td>22,405.09</td>
<td>2.1%</td>
<td>13.4%</td>
<td>22.4%</td>
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<tr>
<td>NASDAQ</td>
<td>6,495.96</td>
<td>1.0%</td>
<td>20.7%</td>
<td>22.3%</td>
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<tr>
<td>Russell 2000</td>
<td>1,490.86</td>
<td>6.1%</td>
<td>9.9%</td>
<td>19.1%</td>
</tr>
<tr>
<td>S&amp;P/TSX Comp</td>
<td>15,634.94</td>
<td>2.8%</td>
<td>2.3%</td>
<td>6.2%</td>
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<tr>
<td>FTSE All-Share</td>
<td>4,049.89</td>
<td>-0.6%</td>
<td>4.6%</td>
<td>7.8%</td>
</tr>
<tr>
<td>STOXX Europe 600</td>
<td>388.16</td>
<td>3.8%</td>
<td>7.4%</td>
<td>13.2%</td>
</tr>
<tr>
<td>EURO STOXX 50</td>
<td>3,594.85</td>
<td>5.1%</td>
<td>9.2%</td>
<td>19.7%</td>
</tr>
<tr>
<td>Hang Seng</td>
<td>27,554.30</td>
<td>-1.5%</td>
<td>25.2%</td>
<td>18.3%</td>
</tr>
<tr>
<td>Shanghai Comp</td>
<td>3,348.94</td>
<td>-0.4%</td>
<td>7.9%</td>
<td>11.5%</td>
</tr>
<tr>
<td>Nikkei 225</td>
<td>20,356.28</td>
<td>3.6%</td>
<td>6.5%</td>
<td>23.7%</td>
</tr>
<tr>
<td>India Sensex</td>
<td>31,283.72</td>
<td>-1.4%</td>
<td>17.5%</td>
<td>12.3%</td>
</tr>
<tr>
<td>Singapore Straits Times</td>
<td>3,219.91</td>
<td>-1.7%</td>
<td>11.8%</td>
<td>12.2%</td>
</tr>
<tr>
<td>Brazil Ibovespa</td>
<td>74,293.51</td>
<td>4.9%</td>
<td>23.4%</td>
<td>27.3%</td>
</tr>
<tr>
<td>Mexican Bolsa IPC</td>
<td>50,346.06</td>
<td>-1.7%</td>
<td>10.3%</td>
<td>6.6%</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Bond yields</th>
<th>9/29/17</th>
<th>8/31/17</th>
<th>9/30/16</th>
<th>12 mo chg</th>
</tr>
</thead>
<tbody>
<tr>
<td>US 2-Yr Tsy</td>
<td>1.483%</td>
<td>1.326%</td>
<td>0.762%</td>
<td>0.72%</td>
</tr>
<tr>
<td>US 10-Yr Tsy</td>
<td>2.334%</td>
<td>2.117%</td>
<td>1.594%</td>
<td>0.74%</td>
</tr>
<tr>
<td>Canada 2-Yr</td>
<td>1.517%</td>
<td>1.275%</td>
<td>0.521%</td>
<td>1.00%</td>
</tr>
<tr>
<td>Canada 10-Yr</td>
<td>2.099%</td>
<td>1.849%</td>
<td>0.996%</td>
<td>1.10%</td>
</tr>
<tr>
<td>UK 2-Yr</td>
<td>0.467%</td>
<td>0.176%</td>
<td>0.102%</td>
<td>0.37%</td>
</tr>
<tr>
<td>UK 10-Yr</td>
<td>1.365%</td>
<td>1.034%</td>
<td>0.746%</td>
<td>0.62%</td>
</tr>
<tr>
<td>Germany 2-Yr</td>
<td>-0.692%</td>
<td>-0.727%</td>
<td>-0.683%</td>
<td>-0.01%</td>
</tr>
<tr>
<td>Germany 10-Yr</td>
<td>0.464%</td>
<td>0.361%</td>
<td>-0.119%</td>
<td>0.58%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Commodities (USD)</th>
<th>Price</th>
<th>1 month</th>
<th>YTD</th>
<th>12 month</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gold (spot $/oz)</td>
<td>1,280.15</td>
<td>-3.1%</td>
<td>11.1%</td>
<td>-2.7%</td>
</tr>
<tr>
<td>Silver (spot $/oz)</td>
<td>16.65</td>
<td>-5.3%</td>
<td>4.6%</td>
<td>-13.2%</td>
</tr>
<tr>
<td>Copper ($/metric ton)</td>
<td>6,432.25</td>
<td>-4.8%</td>
<td>16.5%</td>
<td>32.7%</td>
</tr>
<tr>
<td>Uranium ($/lb)</td>
<td>20.28</td>
<td>0.7%</td>
<td>-0.5%</td>
<td>-9.4%</td>
</tr>
<tr>
<td>Oil (WTI spot/bbl)</td>
<td>51.67</td>
<td>9.4%</td>
<td>-3.8%</td>
<td>7.1%</td>
</tr>
<tr>
<td>Oil (Brent spot/bbl)</td>
<td>57.54</td>
<td>9.9%</td>
<td>1.3%</td>
<td>17.3%</td>
</tr>
<tr>
<td>Natural Gas ($/mmBtu)</td>
<td>3.01</td>
<td>-1.1%</td>
<td>-19.3%</td>
<td>3.5%</td>
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<tr>
<td>Agriculture Index</td>
<td>281.30</td>
<td>0.5%</td>
<td>-3.3%</td>
<td>-4.5%</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Currencies</th>
<th>Rate</th>
<th>1 month</th>
<th>YTD</th>
<th>12 month</th>
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</thead>
<tbody>
<tr>
<td>US Dollar Index</td>
<td>93.0760</td>
<td>0.4%</td>
<td>-8.9%</td>
<td>-2.5%</td>
</tr>
<tr>
<td>CAD/USD</td>
<td>0.8019</td>
<td>0.1%</td>
<td>7.8%</td>
<td>5.3%</td>
</tr>
<tr>
<td>USD/CAD</td>
<td>1.2472</td>
<td>-0.1%</td>
<td>-7.2%</td>
<td>-5.0%</td>
</tr>
<tr>
<td>EUR/USD</td>
<td>1.1814</td>
<td>-0.8%</td>
<td>12.3%</td>
<td>5.2%</td>
</tr>
<tr>
<td>GBP/USD</td>
<td>1.3398</td>
<td>3.6%</td>
<td>8.6%</td>
<td>3.3%</td>
</tr>
<tr>
<td>AUD/USD</td>
<td>0.7834</td>
<td>-1.4%</td>
<td>8.7%</td>
<td>2.2%</td>
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<tr>
<td>USD/JPY</td>
<td>112.5100</td>
<td>2.3%</td>
<td>-3.8%</td>
<td>11.0%</td>
</tr>
<tr>
<td>EUR/JPY</td>
<td>132.9200</td>
<td>1.5%</td>
<td>8.1%</td>
<td>16.7%</td>
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<tr>
<td>EUR/GBP</td>
<td>0.8820</td>
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<td>1.8%</td>
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<tr>
<td>EUR/CHF</td>
<td>1.1440</td>
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<td>USD/SGD</td>
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<td>USD/CNY</td>
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<td>-0.3%</td>
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<td>USD/MXN</td>
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<td>-5.8%</td>
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<td>USD/BRL</td>
<td>3.1623</td>
<td>0.4%</td>
<td>-2.7%</td>
<td>-3.0%</td>
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</tbody>
</table>

Equity returns do not include dividends, except for the German DAX and Brazilian Ibovespa. Equity performance and bond yields in local currencies. U.S. 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 0.80 means 1 Canadian dollar will buy 0.80 U.S. dollar. CAD/USD 5.3% return means the Canadian dollar has risen 5.3% vs. the U.S. dollar during the past 12 months. USD/JPY 112.51 means 1 U.S. dollar will buy 112.51 yen. USD/JPY 11.0% return means the U.S. dollar has risen 11.0% vs. the yen during the past 12 months.


Small-cap stocks outperformed as the prospects for U.S. tax reform rose modestly.

Canadian yields surged after the BoC surprised the market with a rate hike.

Crude oil is now in a bull market as OPEC makes progress reducing the global supply glut.

The pound strengthened along with future rate hike probabilities after higher-than-expected inflation.
Research resources

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<table>
<thead>
<tr>
<th>Rating</th>
<th>Count</th>
<th>Percent</th>
<th>Count</th>
<th>Percent</th>
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<td>Buy [Top Pick &amp; Outperform]</td>
<td>859</td>
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<td>Sell [Underperform]</td>
<td>104</td>
<td>6.41</td>
<td>7</td>
<td>8.41</td>
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