

# Market outlook



FALL 2025

## Equity bull market climbs to new heights



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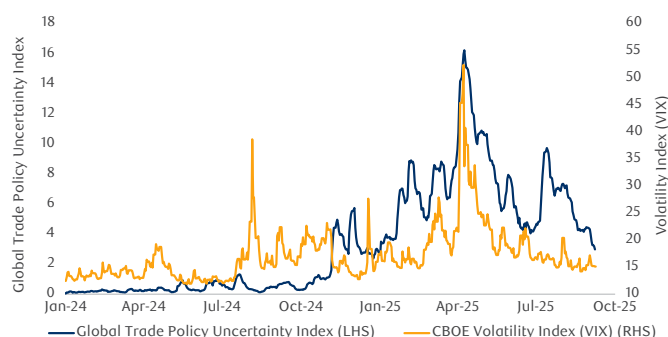
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U.S. policy uncertainty caused significant volatility in asset prices earlier in the year, as investors feared the damage that large-scale tariffs could cause to economic and corporate-profit growth. But progress on trade has been made, with deals being struck between major economies, and the uncertainty has diminished even as tariffs remain in place (Exhibit 1). Investors are moving their focus away from trade policy and instead choosing to recognize the strength in corporate profits, benefits of artificial intelligence and prospect of a resumption in interest-rate cuts by the U.S. Federal Reserve (Fed).

In this environment, stocks extended their gains and most major equity markets reached record levels in the past quarter (Exhibit 2). Importantly, the rally has broadened beyond a small subset of U.S. technology companies to include a wide range of sectors and geographies, with non-U.S. regions outperforming so far this year. While there is

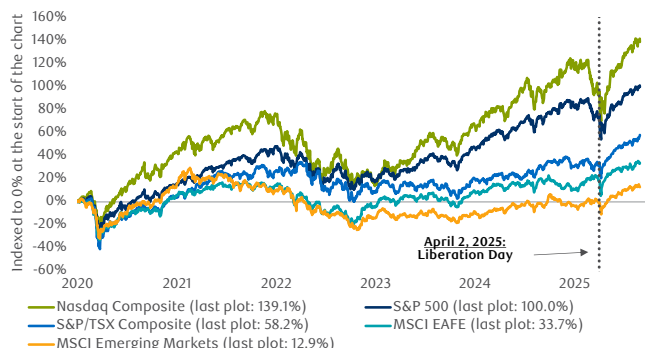
concern that parts of the market are getting expensive, we would point out that, aside from U.S. mega-cap technology, stocks are reasonably or even attractively priced, and that further gains remain possible if economies and corporate profits can continue to grow as we expect.

**Exhibit 1: Global Trade Policy Uncertainty Index**



NNote: As of 09/08/2025. Global Trade Policy Uncertainty Index based on searches in economic, research and government related topics in Bloomberg News and First Word feeds. Source: Bloomberg, Macrobond, RBC GAM

**Exhibit 2: Major equity-market indices**  
Cumulative price returns indices in USD



Note: As of August 29, 2025. Price returns computed in USD. Source: Bloomberg, RBC GAM

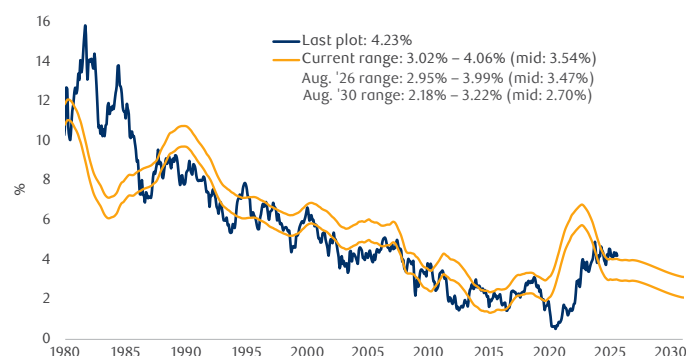
Fixed-income yields have fluctuated in a relatively narrow range as investors weighed the impact of fiscal challenges and inflation concerns against a backdrop of subdued economic growth, weaker labour-market conditions and the potential for interest-rate cuts. While softer job gains and a dovish Fed have weighed on yields, concerns around fiscal health and highly indebted countries have limited declines and at times caused yields to rise. In our view, higher yields ultimately boost the odds that fixed-income investors will enjoy decent returns. We believe bonds are attractively priced, and valuation risk is modest, particularly given that a decline in U.S. short-term interest rates is imminent (Exhibit 3).

Balancing the risks and opportunities, our base case is that the economy will continue to grow at a modest pace, allowing the Fed to resume rate cuts. In this environment, corporate-profit growth should be sufficient to support higher stock prices, although we recognize that lofty U.S. equity valuations may limit the potential for gains in that market. Overall, stocks offer superior return potential versus fixed income. As a result, we added one percentage point to stocks this quarter, sourced from bonds, directing the increased exposure to regions outside of North America. For a balanced global investor, our current recommended asset mix is 62.0% equities (strategic “neutral”: 60.0%), 37.0% bonds (strategic “neutral”: 38.0%) and 1.0% cash.

### U.S. Fed signals rate cuts are imminent

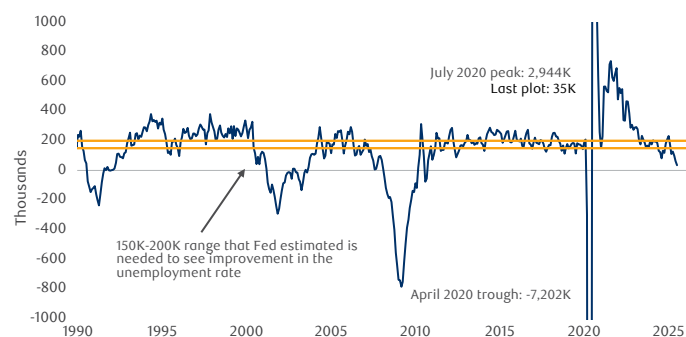
The Fed may soon be ready to resume interest-rate cuts even if inflation remains slightly above target. In late August, Fed Chair Jerome Powell emphasized during a speech in Jackson Hole, Wyoming, that the Fed would place greater weight on the weakening labour market than above-target inflation. Job gains have been slowing, particularly in recent months (Exhibit 4) and, while inflation is still above the 2% target, it is not meaningfully so (Exhibit 5). This situation will likely enable Powell to look past slightly higher near-term inflation and provide the latitude to loosen monetary conditions in support of employment and the broader economy.

### Exhibit 3: U.S. 10-year T-bond yield Equilibrium range



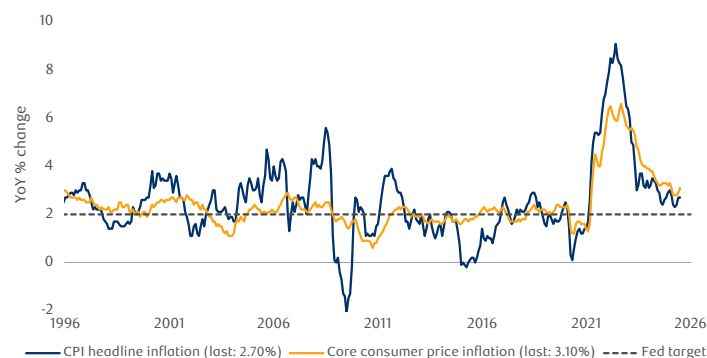
Note: As of August 31, 2025. Source: RBC GAM

### Exhibit 4: United States Monthly change in non-farm employment (3mma)



Note: As of July 2025. Source: Bureau of Labor Statistics

### Exhibit 5: U.S. inflation measures



Note: As of July 31, 2025. Source: Bloomberg, RBC GAM

Investors took Powell's comments in Wyoming as an all-clear for rate cuts to begin in September. Investors are pricing in with near-certainty a rate cut of at least 25 basis points at the September 17 meeting of the Fed's rate-setting committee, with further easing to follow in late 2025 and into 2026 (Exhibit 6). As of August, the market was anticipating between 100 and 125 basis points of cuts over the year ahead. These market-based projections align well with our own thinking in that we expect four rate cuts over the next year.

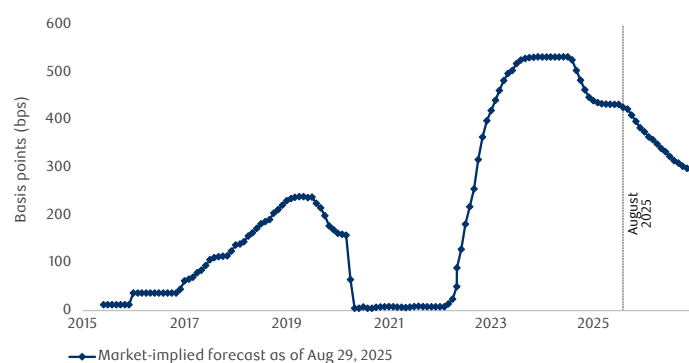
### Road maps: a look at past easing cycles

Past periods of monetary easing may serve as a useful guide for how markets respond to a resumption of Fed easing. Exhibits 7 to 9 plot the historical experience of short-term

interest rates, bond yields and stock prices leading into and following the first cut in any given rate-cutting cycle. The data captures 16 easing cycles since 1950, and T = 0 on the chart indicates the date of the first reduction. The current cycle began in September 2024. It's worth noting that should the Fed resume easing, we would consider the next rate cut an extension of the prior easing cycle rather than the beginning of a new one since no rate hikes have occurred in the interim.

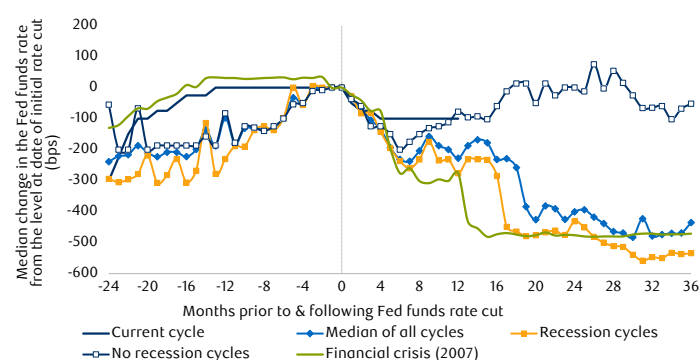
We've grouped the data on the charts based on whether the economy managed a soft landing or entered recession, a distinction that is important because doing so reveals several noteworthy implications for capital markets. In easing instances where the economy entered recession, rate

**Exhibit 6: Implied fed funds rate**  
12-months futures contracts



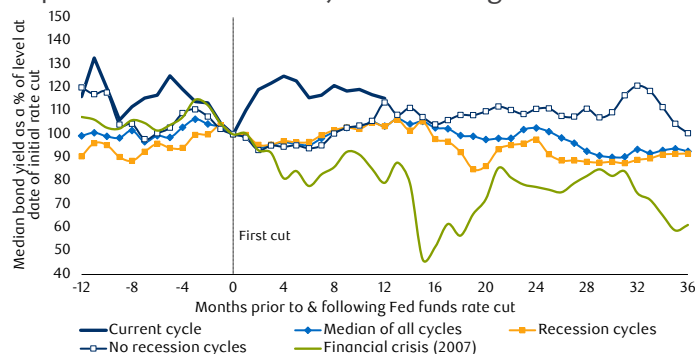
Source: Bloomberg, U.S. Federal Reserve, RBC GAM

**Exhibit 7: Path of the fed funds rate**  
Implications for current cycle, following first rate cut



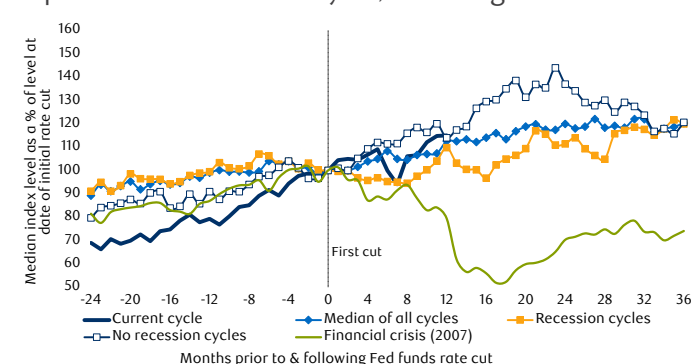
Note: As of August 22, 2025. Source: RBC GAM

**Exhibit 8: U.S. 10-year bond yield and rate cuts**  
Implications for current cycle, following first rate cut



Note: As of August 22, 2025. Source: RBC GAM

**Exhibit 9: S&P 500 and rate cuts**  
Implications for current cycle, following first rate cut



Note: As of August 22, 2025. Source: RBC GAM

cuts were larger in magnitude, bond yields fell and stocks struggled for an extended period. However, in easing cycles where the economy avoids recession and continues to grow (i.e. a soft landing), rate cuts were less pronounced, bond yields moved mostly sideways and stocks continued to rise after a brief period of volatility. Should our base case scenario of modest economic growth and gradual easing of monetary policy play out, stocks will likely outperform.

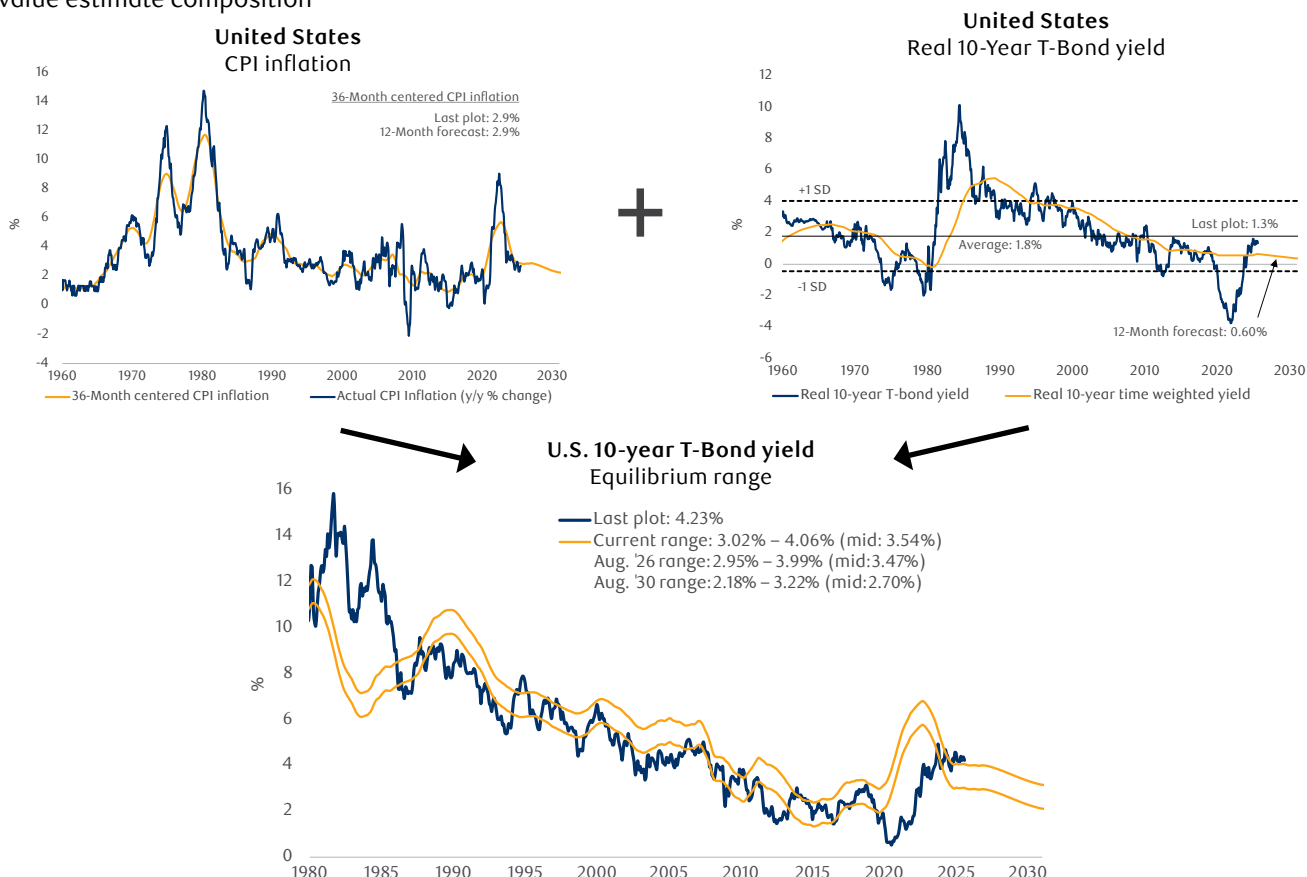
### Sovereign bonds offer decent return potential, with only modest valuation risk

As long as inflation does not return in a big way, our model for the U.S. 10-year Treasury bond suggests investors can earn decent returns with relatively low valuation risk. Exhibit 10 plots the components of our model, which is made up of

an inflation premium and a real, or after-inflation, interest rate. The inflation portion reflects the massive spike from 2021 to 2023, when consumer prices surged due to pandemic-related supply-chain problems that have been resolved. Our model assumes relatively subdued inflation pressures over the years ahead and inflation settling only slightly above the Fed's 2.0% target. That said, most of the recent increase in the U.S. 10-year bond yield has been driven by rising real interest rates as investors grew increasingly concerned about heightened debt levels exacerbated by President Donald Trump's One Big Beautiful Bill, which promises to boost fiscal spending. The current real yield is situated near 1.3%, whereas our model suggests it should be closer to 0.6% to reflect aging populations, slowing longer-term economic growth and an increased preference for saving versus

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

Fair-value estimate composition



Note: As of August 31, 2025. Source: RBC GAM

spending. If our model is right, the U.S. 10-year yield at 4.2% is attractive and situated above equilibrium. We can expect 10-year Treasury bonds to deliver coupon-like returns in the mid single digits over the year ahead, with minimal valuation risk. There is also the added possibility for capital gains if the economy were to stumble.

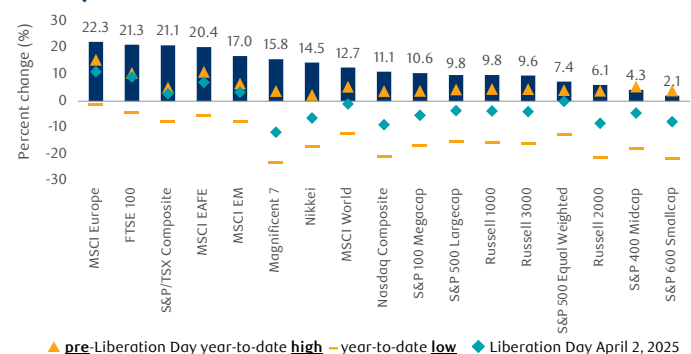
This view that fixed income is appealing holds true across most of the developed world, except for Japan. Bond yields are situated above equilibrium in all the major regions that we track (page 38). But even in Japan, our equilibrium model points to lower yields over the intermediate to longer term as inflation pressures subside. In addition to offering decent return potential, bonds at these higher yields provide critical ballast against equity-market volatility in the context of a balanced portfolio.

### Stocks climb to new highs

Global equities have extended their impressive rebound from earlier this year, with most major markets rallying to record levels. The S&P 500 Index reached as high as 6502, up 30.5% from its April 8 low, bringing the year-to-date gain to 9.8% (Exhibit 11). While returns were initially led by mega-cap technology stocks amid excitement around artificial intelligence, the rally has ultimately featured broad participation from international stocks. The MSCI Europe rose 22% between January 1 of this year and August 31. In the same period, the S&P/TSX Composite Index gained 21%; the MSCI Emerging Markets climbed 17%; and the Japanese Nikkei rose 14%. All the returns were in U.S. dollars, and we should note that performance was bolstered by the weakening greenback.

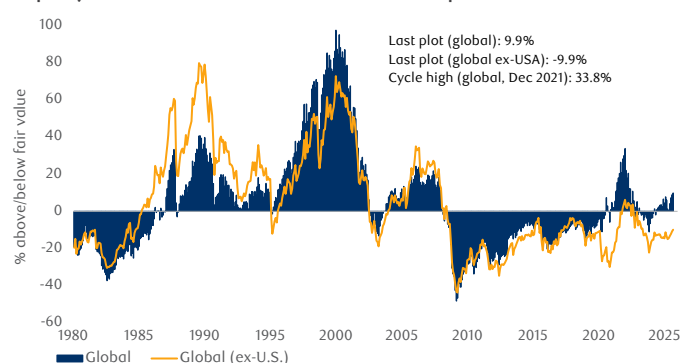
Outsized gains in stocks this year have boosted valuations, but in most cases they are not at levels deemed excessive. Our global stock-market composite suggests that stocks are in aggregate situated 10% above fair value, the highest since 2022 (Exhibit 12). Adjusted for GDP, however, there is meaningful variation in valuations. U.S. large-cap stocks, Canadian equities and Japanese equities are close to one standard deviation above our modelled estimates of fair value, but stocks in Europe, the UK and emerging markets are trading at relatively attractive distances below fair value (page 39). If we exclude the U.S., which is the biggest weighting and most expensive market, we get a different

**Exhibit 11: Major indices' price change in USD 2005 year-to-date**



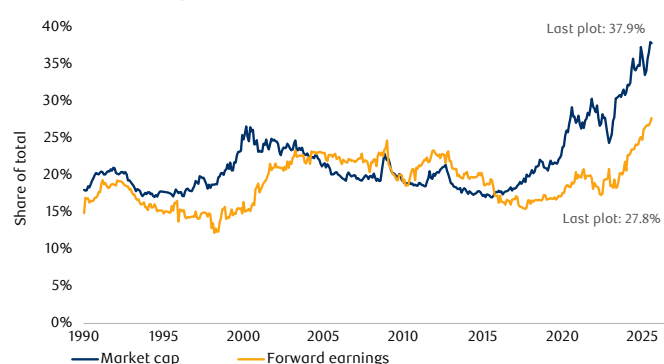
Note: As of August 29, 2025. Magnificent 7 includes Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta and Tesla. Source: Bloomberg, RBC GAM

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



Note: As of August 31, 2025. Source: RBC GAM

**Exhibit 13: Top 10 stocks as a share of S&P 500 Index**



Note: As of Aug 31, 2025. Source: RBC GAM

perspective. As indicated by the yellow line on the chart, valuations of stock markets outside the U.S. have also been climbing but are still 10% below fair value. The upshot is that non-U.S. equity markets are relatively appealing should the global economy and corporate profits continue to grow.

### S&P 500 concentration becomes even more acute

The unmatched performance of U.S. large-cap equities in recent years has led to understandable concern that a small group of stocks makes up a disproportionate share of the index. The top 10 stocks by market capitalization now account for a record 37.9% of the S&P 500's weighting, and this number has been rising for the past decade (Exhibit 13). These successful companies generate a significant share of index earnings at 27.8%, and the significant gap between index weightings and index profits indicates strong earnings growth will be required to maintain the valuations of these mega-cap technology stocks. Should these companies stumble, they would have a massive influence on the overall index.

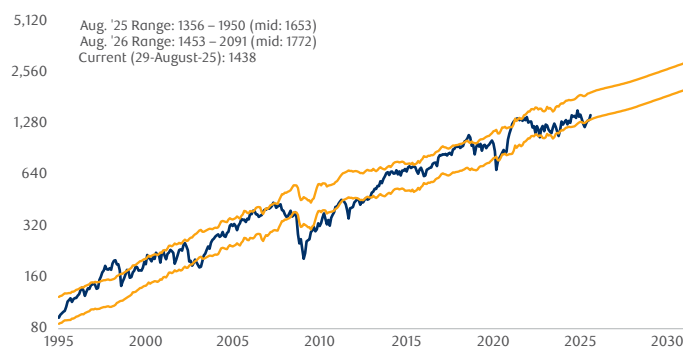
### U.S. equities are reasonably priced outside of mega caps

While the market-cap-weighted version of the S&P 500 is expensive due to an elevated concentration of high-priced stocks, we don't view the entire U.S. stock market as being overly rich. Smaller capitalization stocks, for example, are less expensive and trading close to the lower boundary of their fair-value channel (Exhibit 14). But because of their modest influence on the capitalization-weighted S&P 500, small-cap stocks have little effect on overall S&P 500 valuations. To get a better idea of the average stock, we instead look at the S&P 500 Equal Weight Index, which assigns a 1/500 weight to each issue in the index regardless of its market capitalization. This version of the S&P 500 is trading near the midpoint of our fair-value channel (Exhibit 15). As a result, we conclude that the overvaluation in the S&P 500 is highly concentrated in the mega-cap names, while the broader market is more reasonably priced.

### Earnings strengthen even with tariff headwinds

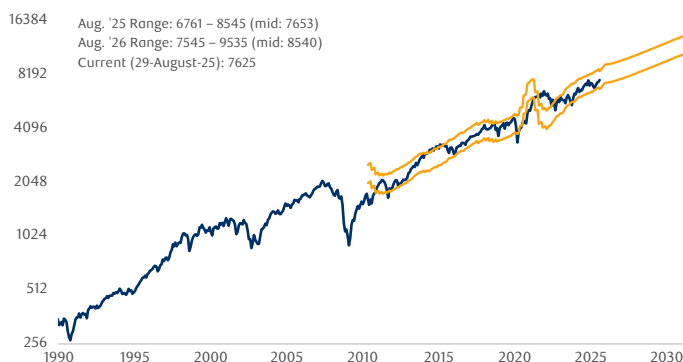
While valuations are important, the ultimate driver of stocks is earnings growth, and corporate-profit reports have been much better than expected. In the second calendar quarter, S&P 500 profits climbed 13.3% on a year-over-year basis versus estimates of just 5.8%, as four-fifths of companies beat estimates (Exhibit 16). Analysts had overestimated the

**Exhibit 14: S&P 600 equilibrium**  
Normalized earnings & valuations



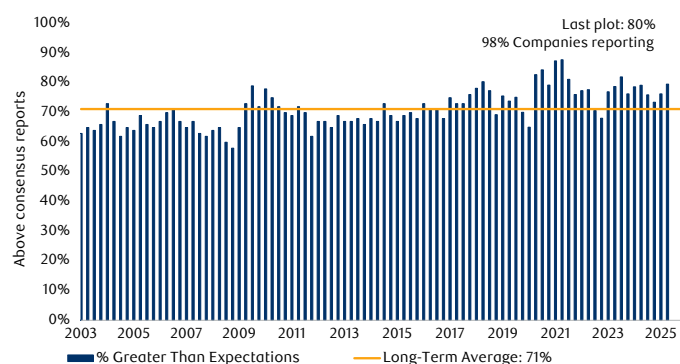
Source: RBC GAM

**Exhibit 15: S&P 500 Equal Weighted equilibrium**  
Normalized earnings & valuations



Source: RBC GAM

**Exhibit 16: S&P 500 companies reporting results above consensus forecasts**

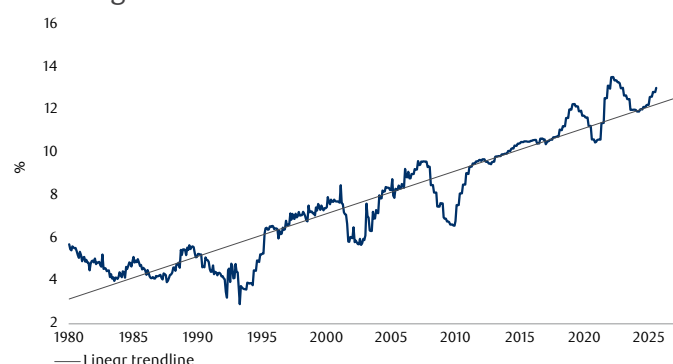


Note: As of August 29, 2025. Source: Refinitiv

negative impact of tariffs, thinking higher costs would lead to lower profit margins. But companies were able to either raise prices enough to offset the tariff impact or found ways to avoid it altogether. As a result, profit margins widened and are just shy of a new record (Exhibit 17). The ability of U.S. large-cap companies to deliver strong profit growth even in the face of a challenging macroeconomic backdrop has led analysts to raise their forecasts. The consensus estimate is now for healthy 10.5% earnings growth this year, followed by an even faster 13.7% clip in 2026 (Exhibit 18).

**Exhibit 17: S&P 500 Index**

Net margin



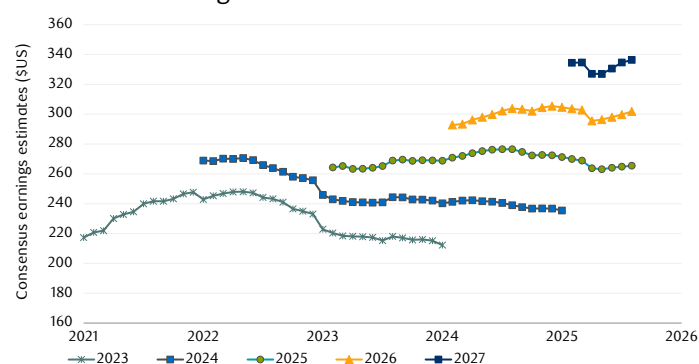
Note: As of August 2025. Source: Bloomberg, RBC GAM

**Scenarios suggest limited upside for the S&P 500**

Although investors are highly optimistic about the earnings outlook for the S&P 500, today's elevated starting point for valuations will make strong returns difficult to achieve. Exhibit 19 outlines a variety of scenarios for the S&P 500 based on combinations of price-to-earnings ratios (P/E) and earnings per share. At close to 6500 at the time of this writing, the S&P 500 has already traded through all but the most extreme positive scenario in the 2025 table. Looking ahead to 2026, stocks could still generate decent returns as long as the S&P 500 trades at least 1 full standard deviation above equilibrium – i.e. the level consistent with the current

**Exhibit 18: S&P 500 Index**

Consensus earnings estimates



Note: As of August 29, 2025. Source: Bloomberg, RBC GAM

**Exhibit 19: Earnings estimates and alternative scenarios for valuations and outcomes for the S&P 500**

|  |  | Consensus | Total Return |  |  | Consensus | Annualized   |
|--|--|-----------|--------------|--|--|-----------|--------------|
|  |  | 2025      | 2025         |  |  | 2026      | Total Return |
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|  |  | 2025      | 2025         |  |  | 2026      | 2026         |
|  |  | 2025      | 2025         |  |  | 2026      | 2026         |
|  |  | 2025      | 2025         |  |  | 2026      | 2026         |
|  |  | 2025      | 2025         |  |  | 2026      | 2026         |
|  |  | 2025      | 2025         |  |  | 2026      | 2026         |
|  |  | 2025      | 2025         |  |  | 2026      | 2026         |
|  |  | 2025      | 2025         |  |  | 2026      | 2026         |
|  |  | 2025      | 2025         |  |  | 2026      | 2026         |
|  |  | 2025      | 2025         |  |  |           |              |

Note: As of August 29, 2025. Total returns for 2026 are annualized. Source: LSEG I/B/E/S, RBC GAM

interest rate and inflation environment – and earnings come in at the US\$303.20 level that analysts are forecasting. Assuming both conditions are met, the S&P 500 could trade at 6788 by the end of next year for an annualized total return of 5%. The S&P 500 could reach between 7000 and 8000 next year if valuations approach 2 standard deviations above equilibrium. However, history shows that valuations much beyond 1 full standard deviation aren't sustainable (Exhibit 20). These scenarios highlight that the path to a positive outcome is possible, but achieving it will require maintaining elevated investor confidence in combination with the persistence of strong earnings growth.

### Styles: large-cap growth leadership could be stalling after a strong run

The leadership of the U.S. stock market could be shifting to smaller-cap and value stocks after a strong run in large-cap growth stocks since President Trump's "Liberation Day" (i.e. April 2, 2025). While a rotation is hard to detect on longer-term charts, value stocks outperformed growth stocks by 2.7 percentage points in August, the largest gap since March (Exhibit 21). And small caps outperformed large caps by 4.9 percentage points in August, their largest monthly outperformance since November 2024 after Trump's election victory (Exhibit 22). While it may be too early to tell if these moves represent a lasting change, a sustained shift in leadership toward value and small-cap stocks would confirm that an acceleration in economic and corporate-profit growth likely lies ahead.

### Exhibit 20: S&P 500 Index

Normalized (Equilibrium) Price/Earnings Ratio



Note: As of August 29, 2025. Source: RBC GAM

### Exhibit 21: Value vs. growth relative performance

S&P 500 Value Index / S&P 500 Growth Index



Note: As of September 5, 2025. Source: Bloomberg, RBC GAM

### Exhibit 22: Small vs. large cap relative performance

S&P Small Cap 600 vs. S&P 500



Note: As of September 5, 2025. Source: Bloomberg, RBC GAM



### Geographies: international markets outperform

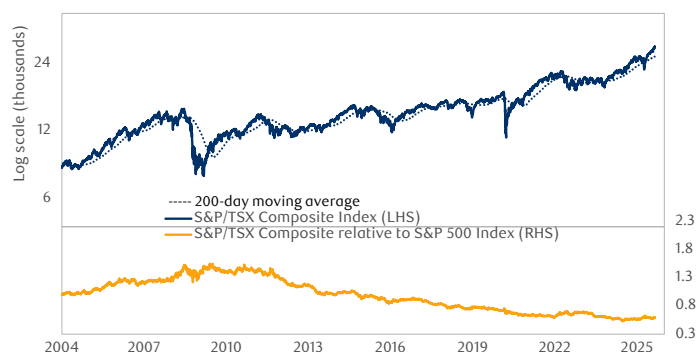
International markets have outperformed in a meaningful way so far this year, and we think they could have further to go. Exhibits 23 to 25 plot a variety of global stock markets, with their relative performance versus the S&P 500 shown in the bottom panel of each chart. Note that non-U.S. markets have stabilized versus the S&P 500 and even started to outperform after nearly 15 years of uninterrupted underperformance. Canada's S&P/TSX, the MSCI Emerging Markets and the MSCI EAFE have all outpaced the S&P 500 by around 10 percentage points so far this year. The relative surge in non-U.S. markets may appear as only a blip on the long-term chart, but our sense is that the outperformance could be in its early stages, particularly since the valuation gap between the U.S. large-cap market and the rest of the world has become especially wide.

### Asset mix – adding to equity allocation, favouring non-U.S. regions

Our asset allocation reflects our base case view as well as consideration of other scenarios that could unfold. In our base case, the economy continues to grow at a modest pace and inflation remains calm enough to allow the Fed to resume interest-rate cuts as early as September. We recognize, however, that there are still risks with respect to tariffs and trade policy, geopolitical tensions, and rising investor concern about highly indebted governments.

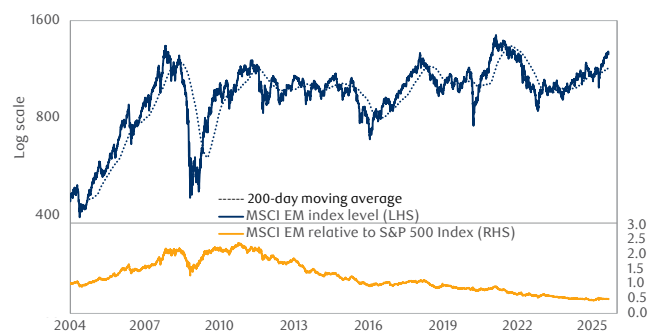


### Exhibit 23: S&P/TSX Composite Index



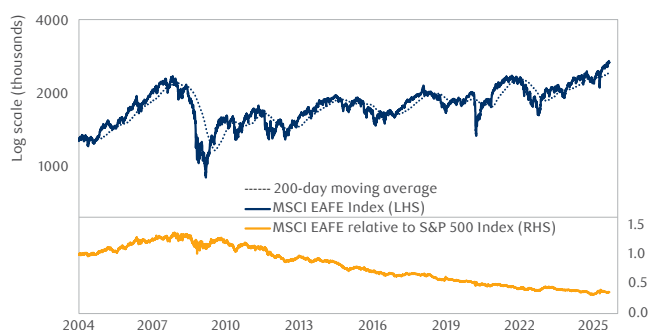
Note: As of August 29, 2025. Source: RBC GAM

### Exhibit 24: MSCI Emerging Markets Index



Note: As of August 29, 2025. Source: RBC GAM

### Exhibit 25: MSCI EAFE Index



Note: As of August 29, 2025. Source: RBC GAM

In this environment, we expect bonds to deliver modest returns in the mid single digits over the medium to longer term. The historical relationship between yields and subsequently realized returns suggests that a good estimate for fixed-income returns over time is the current yield-to-maturity, which is 4.2% in the U.S. at the time of writing (Exhibit 26). In the near term, we expect fixed-income investors to be able to earn mid single digit returns as long as inflation doesn't rise to uncomfortable levels, with the possibility of higher returns should the economy encounter trouble.

Stocks offer superior return potential versus fixed income, although we recognize that high valuations in U.S. large-cap equities may limit gains. While valuations are not necessarily good near-term timing indicators, they correlate well with returns over longer time horizons as indicated by the strong relationship between Shiller's CAPE ratio and 10-year returns for the S&P 500 (Exhibit 27). The chart, which plots the CAPE alongside subsequent 10-year returns for the S&P 500 (reversed on the chart), indicates that extremely high valuations tend to be followed by relatively low returns, and vice versa. As U.S. large-cap stocks have delivered outsized gains over the past several years, valuations have climbed to levels not seen since the late 1990s technology bubble, which were followed by relatively weak returns for the following decade. A current CAPE of 31.5 suggests mid-single-digit returns for the S&P 500 over the next decade, still above that of fixed income. But the risk premium versus bonds is relatively narrow.

Our view that stocks are likely to outperform bonds in the current environment has motivated us to add one percentage point to our equity allocation, sourced from fixed income. But valuation concerns regarding U.S. large-cap growth stocks have prompted us to direct our equity overweight toward Europe, Asia and emerging markets. For a balanced global investor, our current recommended asset mix is 62.0% equities (strategic "neutral": 60.0%), 37.0% bonds (strategic "neutral": 38.0%) and 1.0% cash.

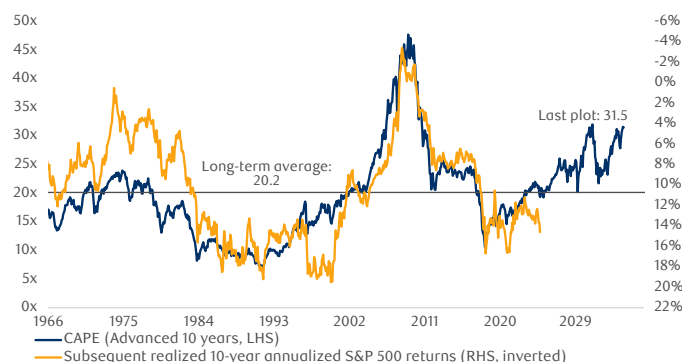
**Exhibit 26: U.S. 10-year Treasury note and returns**



Note: August 29, 2025. Source: Deutsche Bank, Macrobond, RBC GAM

**Exhibit 27: Shiller's CAPE**

Real S&P 500 Index / 10-year average of real EPS

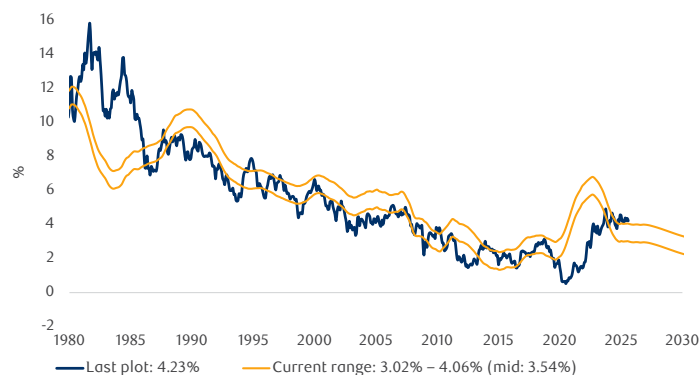


Note: As of Aug 29, 2025. Source: Macrobond, Bloomberg, RBC GAM

## Global fixed income markets

### U.S. 10-Year T-Bond Yield

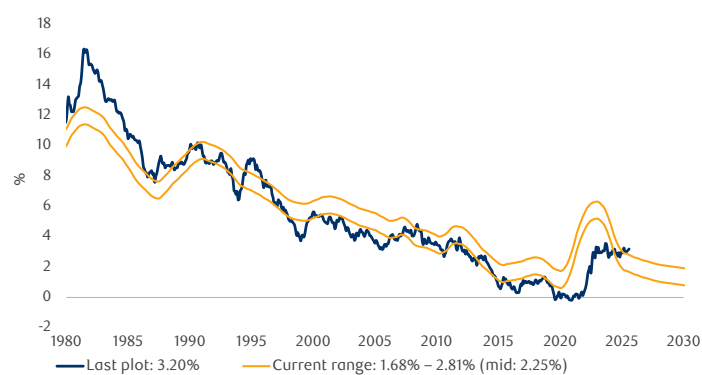
Equilibrium range



Note: As of August 29, 2025. Source: RBC GAM

### Eurozone 10-Year Bond Yield

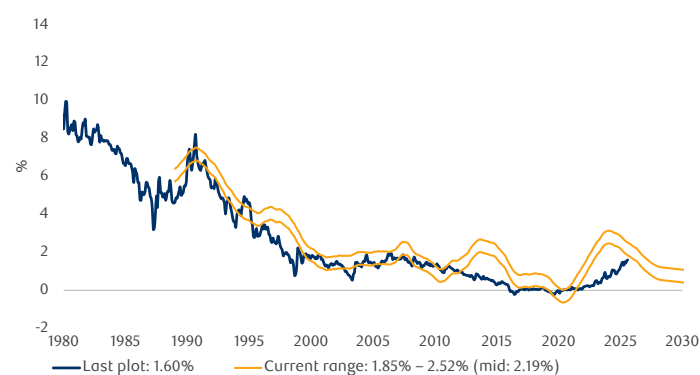
Equilibrium range



Note: As of August 29, 2025. Source: RBC GAM

### Japan 10-Year Bond Yield

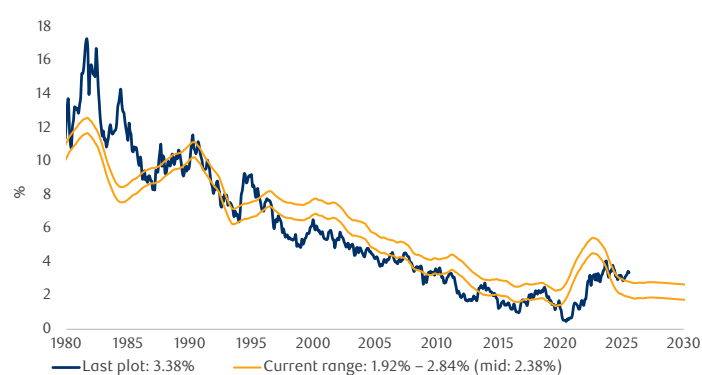
Equilibrium range



Note: As of August 29, 2025. Source: RBC GAM

### Canada 10-Year Bond Yield

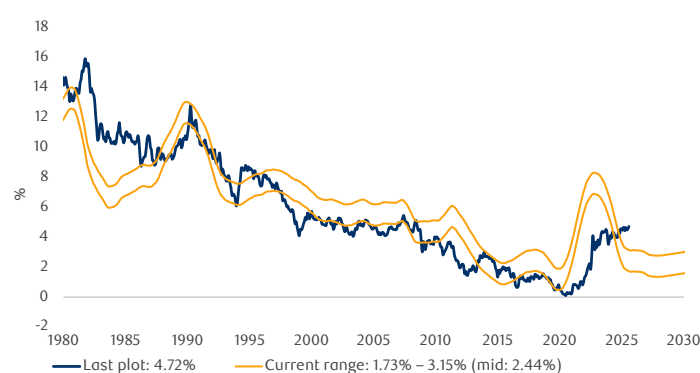
Equilibrium range



Note: As of August 29, 2025. Source: RBC GAM

### UK 10-Year Gilt

Equilibrium range



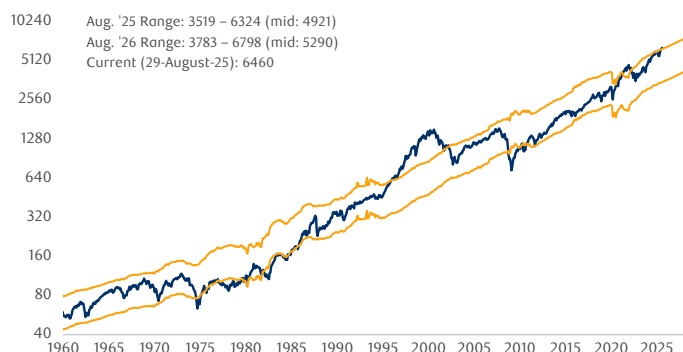
Note: As of August 29, 2025. Source: RBC GAM

“Our equilibrium model points to lower yields over the intermediate to longer term as inflation pressures subside.”

## Global equity markets

### S&P 500 Equilibrium

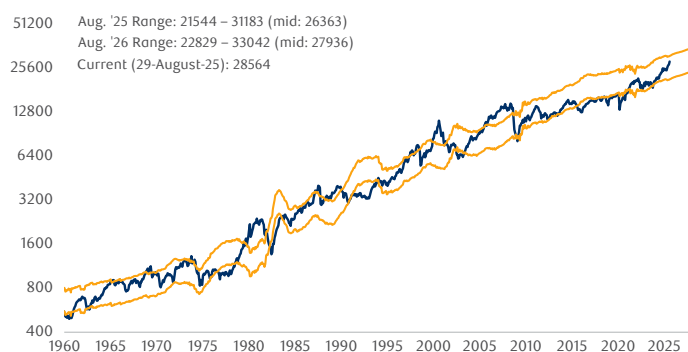
#### Normalized earnings and valuations



Note: As of August 29, 2025. Source: RBC GAM

### S&P/TSX Composite Equilibrium

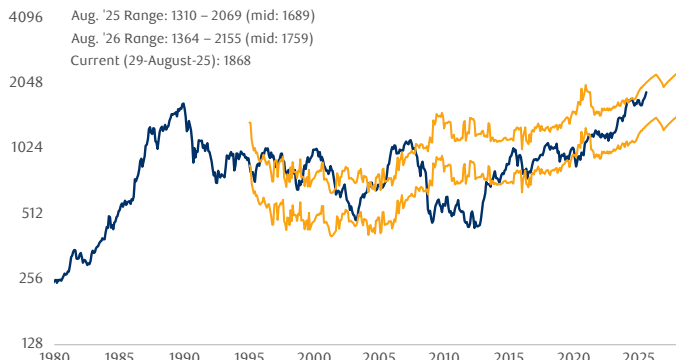
#### Normalized earnings and valuations



Note: As of August 29, 2025. Source: RBC GAM

### MSCI Japan Index

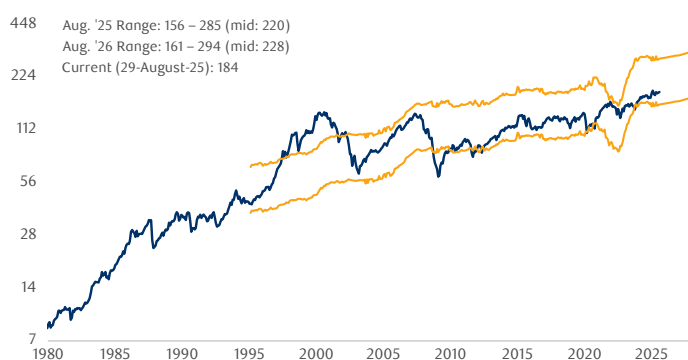
#### Normalized earnings and valuations



Note: As of August 29, 2025. Source: RBC GAM

### MSCI Europe Index

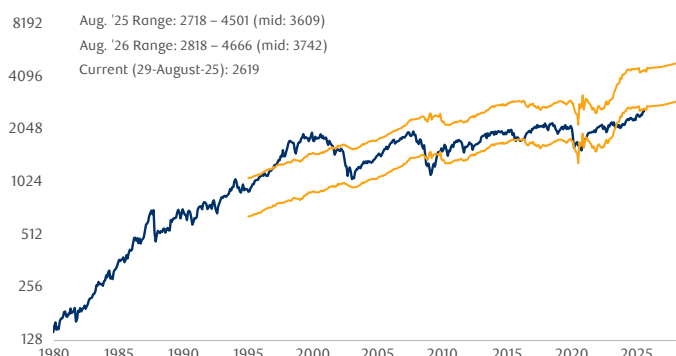
#### Normalized earnings and valuations



Note: As of August 29, 2025. Source: RBC GAM

### MSCI UK Index

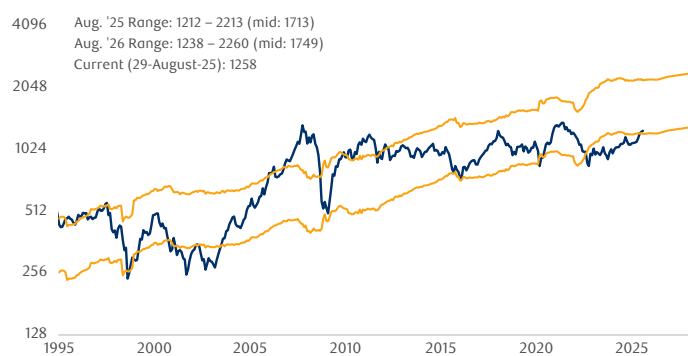
#### Normalized earnings and valuations



Note: As of August 29, 2025. Source: RBC GAM

### MSCI Emerging Markets Index

#### Normalized earnings and valuations



Note: As of August 29, 2025. Source: RBC GAM

Note: The fair value estimates are for illustrative purposes only. Corrections are always a possibility and valuations will not limit the risk of damage from systemic shocks. It is not possible to invest directly in an unmanaged index.

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