RBC Global Asset Management

Insights

RBC Portfolio Solutions

Spring 2023

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Making sense of mixed economic signals

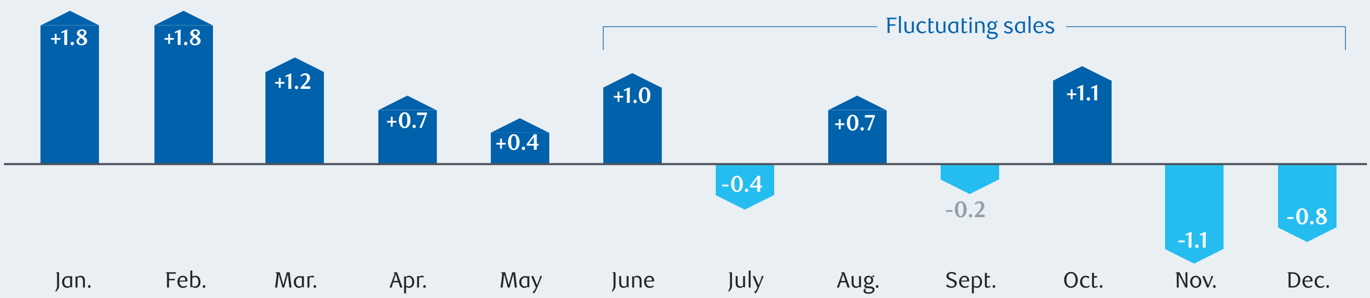
Consumer spending fell one month but rebounded the next. Jobs are plentiful, but so are headlines about layoffs. And most recently, we've seen financial stress bubble to the surface in the banking sector, an unintended consequence of higher interest rates. The economy is slowing in some aspects, but resilient by other measures. Suffice it to say, current signals are mixed.

In this quarter's Insights we explore the tug-of-war taking place in the economy and how our portfolios are built to keep you well positioned in any environment.

Up or down?

Retail sales are one of the many data points we use to gauge consumer sentiment. While it fluctuated over the past year, there is more to this story. Inside, we detail some of the signs we are watching.

Month-over-month percentage change in U.S. retail sales in 2022



As of 03/15/2023. Source: United States Census Bureau. Advance monthly sales for retail and food services.

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The push and the pull: Today's markets and the economy

As illustrated through consumer spending patterns, the economy doesn't move in a straight line. Traditionally, the signs of a strengthening economy lift financial markets higher while signs of economic weakness may pull markets lower. We take a deeper dive into a few economic indicators to better understand their current state and, more importantly, anticipate what might be coming next.

Consumer spending – fluctuating

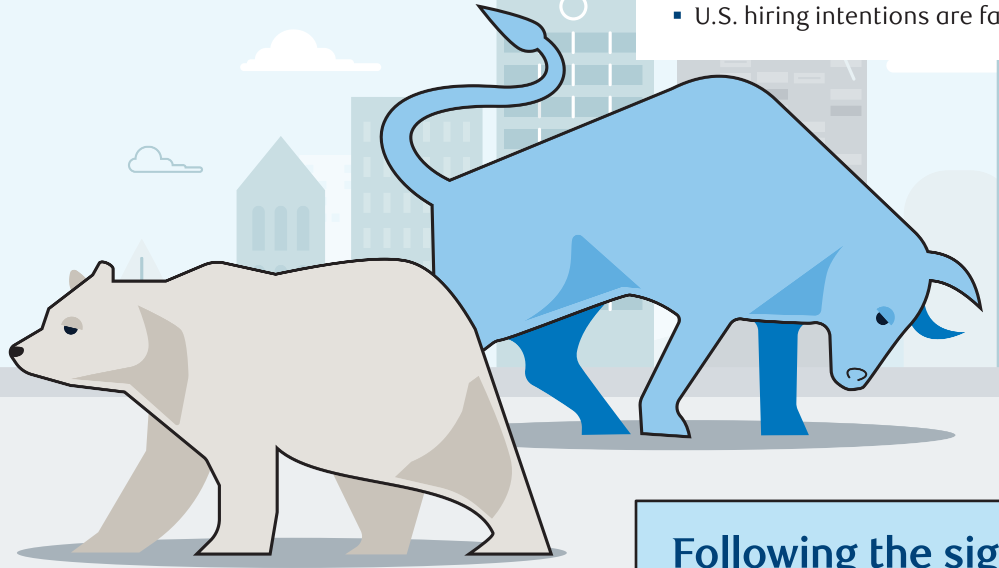
Consumers are considered the growth engine for many economies. Spending and spending intentions provide clues about the path for future demand.

Month-over-month changes in U.S. retail sales[1]

December 2022	January 2023	February 2023
-0.8%	3.2%	-0.4%

Declining retail sales at the end of 2022 pointed to consumers tightening their purse strings. While sales have fluctuated one month to the next, under the surface there is growing evidence of a consumer that may be stretched.

- **U.S. credit card borrowing increased by 15% in 2022.[2]**
- **Personal saving rates are lower than they were before the pandemic.**



Labor market – resilient, but may be softening

5.0% Canadian unemployment[3]

3.6% U.S. unemployment[4]

By many measures the labour market shows resilience, with unemployment levels at multi-decade lows. Yet, some signs are pointing to softening.

- Announcements of U.S. job cuts recently surged[5]
- U.S. hiring intentions are falling[6]

Business sentiment – low

Unfavorable market conditions may encourage firms to pull back on hiring, investment, and production.

U.S. business expectations plunged and remain weak despite a recent uptick. It's a similar story in Canada, as more firms anticipate slowing economic activity.

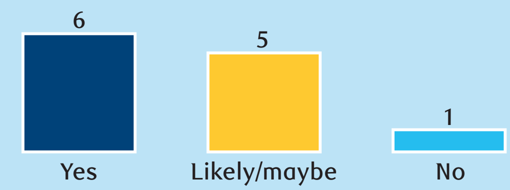
U.S. business expectations composite

As of Feb 2023. Principal component analysis using National Federation of Independent Business (NFIB) optimism and business conditions outlook, ISM Manufacturing and Services new orders, and the Conference Board CEO expectations for economy. Source: The Conference Board, ISM, NFIB, Macrobond, RBC GAM.

Following the signs

Economic signals may be mixed from one report to next. We focus on the trends that are forming, rather than a single data point. In our view, a recession is more likely than not for most of the developed world in the second half of 2023.

Signals predicting a recession



As at 03/03/2023. Analysis for U.S. economy. Source: RBC GAM. Based on 12 indicators that have historically been triggered in advance of recessions. For more details on these indicators please see our #MacroMemo (rbcgam.com/macromemo).

While we anticipate a recession, we expect a fairly sprightly recovery over the later part of 2024.

What it means for your portfolio

We consider a wide range of scenarios, including the possibility of a recession, as we position your portfolio for the rest of 2023 and beyond.

Financial markets are much more attractively priced than they were a year ago. Both stocks and bonds offer improved long-term return potential relative to 2022.

Given the uncertainty in the markets and the economy, we are maintaining a cautious approach to risk-taking in the near term. We continue to diversify your portfolio in several ways to prepare it for a wide range of market forces.

1. We are holding more fixed income in your portfolio than we have in recent years, since interest rates are now at levels where bonds should better offset a downturn in stocks. While we have worked to gradually de-risk our portfolios in light of heightened uncertainty in the markets, our exposure to stocks means we can take advantage of growth opportunities as they arise in 2023 and beyond.
2. We invest across many industries and sectors with different levels of sensitivity to market cycles.
3. We also invest across regions with different interest rate regimes and inflationary environments.

To keep up with RBC GAM's view on the evolving investment environment see the Spring Global Investment Outlook. (rbcgam.com/gio).

[1] As at 03/15/2023. Advance monthly sales for retail and food services. Source: United States Census Bureau.
[2] As of Q3 2022. Source: Federal Reserve Bank of New York, Macrobond, RBC GAM.
[3] Labour Force Survey, February 2023. Source: Statistics Canada.
[4] Employment Situation Summary, February 2023. Source: U.S. Bureau of Labor Statistics.
[5] As of January 2023. Source: Challenger, Gray & Christmas, Inc., Macrobond, RBC GAM.
[6] As of December 2022. Hiring intentions index based on combination of seven surveys of hiring intentions. Source: Macrobond, RBC GAM.

Portfolio manager viewpoint

Sarah Riopelle, CFA, Vice President & Senior Portfolio Manager, Investment Solutions

The economy has been resilient, and it has been this very strength, combined with inflationary pressures, that has pushed central banks to deliver aggressive interest rate hikes, which will likely send economies into recession. Weakness is already being seen in the housing market, rising goods inventories, diminished business confidence and scaled-back capital spending. Moreover, troubles have surfaced in a handful of U.S. regional banks. With yields at their highest level in a decade, sovereign bonds should act as ballast against any downturn in stocks within a balanced portfolio. Moreover, cash has become a more suitable holding at today's higher interest rates. Reflecting heightened uncertainty in the macroeconomic backdrop and an unusually wide range of potential outcomes, we trimmed our equity allocation by 100 basis points early in the quarter, placing half the proceeds in bonds and the other half in cash. This was followed by another 100 basis point shift from equity to cash, closing our overweight position in stocks in mid-March. Our asset mix is now the closest to neutral that it has been in several years.

Markets this quarter*

3.2%	3.2%	4.6%	7.3%	8.3%	3.8%
Canadian fixed income	**Global fixed income**	**Canadian equities**	**U.S. equities**	**International equities**	**Emerging market equities**
FTSE Canada Universal Bond Index	FTSE World Government Bond Index (CAD hedged)	S&P/TSX Composite Index	S&P 500 Index	MSCI EAFE Index	MSCI Emerging Markets Index

For our complete Spring 2023 Global Investment Outlook, please visit rbcgam.com/gio

*Source: Bloomberg. As of March 31, 2023. All returns are in C$ except where indicated. Canadian, U.S., International and Emerging Markets index returns are total returns. An investment cannot be made directly into an index. The above does not reflect transaction costs, investment management fees or taxes. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results.

We thank you for your ongoing trust in continuing to hold RBC Portfolio Solutions as part of your investment plan. If you have any questions or comments, please contact your advisor.

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