RBC Global Asset Management

Executive summary

FALL 2024

Eric Savoie, MBA, CFA, CMT
Investment Strategist
RBC Global Asset Management Inc.

Daniel E. Chornous, CFA
Chief Investment Officer
RBC Global Asset Management Inc.

The intense economic headwind from high interest rates is fading and relief is on the way as reduced inflation pressures have paved the way for central banks to loosen monetary conditions. Against this backdrop of falling rates, we think the economy is likely to achieve a soft landing where economic growth is sufficient to lift corporate profits and stock prices. High valuations in mega-cap technology stocks, in particular, could limit return potential.

Growth moderates, but soft landing is most likely scenario

The global economy continues to decelerate and, while a mild recession is possible given deterioration in labour markets, we think the most likely scenario is that economies continue to expand over our forecast horizon. Tempered growth and cooling inflation are a welcome combination that have nudged central banks to reduce interest rates from current restrictive levels to support growth over the months and quarters ahead. Slowing economic growth, the diminishing consumer-price pressures and falling interest rates should lead to a macroeconomic environment that is more in line with historic norms in a few years. Our base case is one where developed-world economies expand at a modest pace over the next few quarters, accelerating slightly into 2025 helped by the lagged benefit of interest-rate cuts. We expect emerging markets to follow a similar trajectory, though growth is likely to be faster in India and China. Our benign outlook is subject to a variety of risks, and the key sources of uncertainty include geopolitical tensions in the Middle East, Ukraine and China, as well as the U.S. election in November.

Inflation progressing well toward targets

Inflation, a key focus of investors and policymakers in the years immediately following the pandemic, is becoming less of a concern. U.S. headline consumer-price inflation fell to 2.5% in August 2024 from a high of 9.1% in mid-2022, and a variety of other inflation measures have also eased meaningfully. Moreover, key inflation drivers provide encouraging signals about the future. The U.S. economy is no longer overheating, wage growth continues to slow and corporations are less inclined to raise prices. Inflation expectations remain well anchored as a result. Should the economy end up growing faster than anticipated, though, inflation pressures could prove more challenging to contain. Other upside risks to inflation consist of possible shocks related to the price of oil, perhaps in the event of escalating geopolitical tensions. Taking everything together, we forecast a further gradual deceleration in inflation in 2025, with figures that look increasingly normal and closer to central bankers' 2% targets.

U.S. dollar is weakening

The U.S. dollar has ceded much of what it gained in the first half of the year and now sits 8% below its 2022 high. We expect the greenback to fall further in the coming months, and recent developments indicate that the more substantial drop that we have been forecasting may finally occur. We forecast that the euro will be the best performing developed-market currency versus the dollar over the next year, with near double-digit returns, and anticipate that other currencies will also benefit from broad U.S.-dollar weakness.

More central banks join rate-cutting trend, with the U.S. not far behind

With interest rates starting from elevated levels and inflation falling toward 2%, rate cuts are now justified to provide relief for consumers and businesses. Many of the world's major central banks have already started lowering rates, including the European Central Bank, the Bank of Canada, and the Bank of England, while the U.S. Federal Reserve has signalled it will likely cut rates in September. In the context of our forecast for modest economic growth and cooling inflation, it is reasonable to expect steady monetary easing over 2025. A sustained period of interest-rate relief is important given that U.S. policy rates are currently as much as 2.5 percentage points above neutral levels. While central banks may not manage to lower rates all the way back to neutral over our one-year forecast horizon, significant progress in that direction is likely. The actual magnitude and speed of easing will ultimately depend on the economy's trajectory.

Return potential in sovereign bonds moderated as yields plunged

With the U.S. 10-year yield falling below 4% in August to its lowest level in the past year, we think that sovereign bonds are now reasonably priced. Assuming that real, or after-inflation, interest rates settle around 1% and that the inflation premium embedded in nominal bonds is around 3% on its way down to 2% over the longer term, then the midpoint of our equilibrium band for U.S. 10-year Treasurys is around 4%. Our models suggest there is scope for yields to continue falling, but only slightly so over the medium to longer term. The decline in yields that we've seen since the spring is consistent with past periods of monetary easing, and history suggests that the bulk of the decline in bond yields is already behind once policy rates start their descent. As a result, we look for yields to trend mostly sideways over the year ahead. While fixed-income investors have enjoyed mid single-digit gains in the past quarter alone, we think returns in sovereign bonds are likely to moderate to the mid to low single digits over the next 12 months in the U.S. and probably less in regions outside the U.S.

Stocks extend gains, valuation risk concentrated in U.S. large-cap growth stocks

In equity markets, mega-cap technology stocks have greatly benefited from optimism regarding the productivity improvements that artificial intelligence could bring, but the enthusiasm for these stocks may be getting tested. Over the past year, the "Magnificent-7"– a group of U.S. mega-cap technology stocks – have gained an average of 38%, far exceeding returns in other parts of the market. The resulting extreme valuations in these stocks could limit further gains and, even with impressive recent profit reports, U.S. mega-cap technology stocks stumbled in the later part of the past quarter ended August 31. While the S&P 500 Index sits near the top of its fair-value channel, stocks in Canada, the UK, Europe and emerging markets are all trading below fair value and in some instances at particularly attractive discounts. Should the economy experience a soft landing, appealing opportunities exist in sectors that haven't fully participated in global stock gains since the start of the year, such as in small caps, international equities and value stocks, where gains have accelerated since July. Overall, we look for equities to deliver mid to high single-digit returns over the year ahead, and we favour segments of the market where valuations are less demanding.

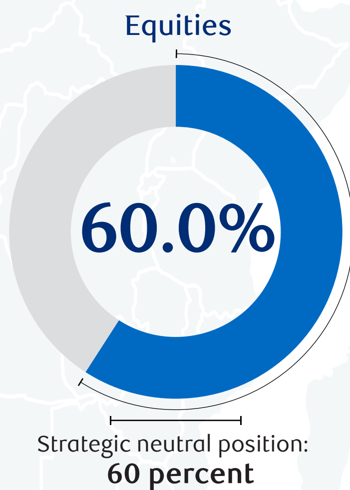
Asset mix – reduced bond allocation to slight underweight

Balancing the risks and potential rewards, we have trimmed our fixed-income allocation this quarter, moving the proceeds to cash. The substantial decline in bond yields in the past quarter means that much of the anticipated interest-rate adjustment back toward a neutral setting is already priced into fixed-income markets. As a result, we believe bonds will offer less appealing returns absent a recession. We have reduced our fixed-income exposure by 150 basis points, moving it to a modest underweight position from a slight overweight position. We opted against moving the funds directly into stocks given the potential for heightened volatility in the near term, as investors await additional clarity on the economy's trajectory. We would gain more confidence that stocks can move sustainably higher should we see further evidence that the economy is headed for a soft landing and/or we observe a sustained shift in market leadership to smaller caps, value stocks and international equities. For a balanced global investor, we currently recommend an asset mix of 60.0 percent equities (strategic neutral position: 60.0 percent) and 37.0 percent fixed income (strategic neutral position: 38.0 percent), with the balance in cash.

Recommended asset mix

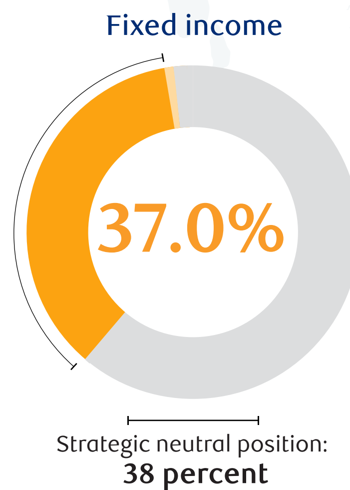
RBC GAM Investment Strategy Committee

Equities



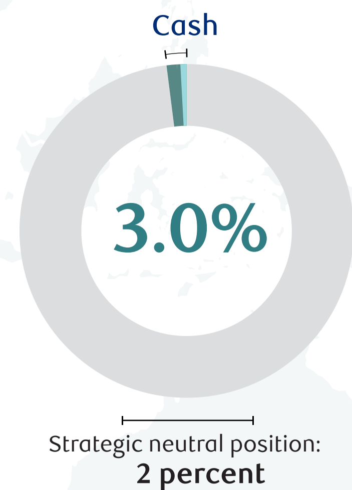
Strategic neutral position:
60 percent

Fixed income



Strategic neutral position:
38 percent

Cash



Strategic neutral position:
2 percent

Note: As of August 31, 2024. Source: RBC GAM

Disclosure

This document is provided by RBC Global Asset Management (RBC GAM) for informational purposes only and may not be reproduced, distributed or published without the written consent of RBC GAM or its affiliated entities listed herein. This document does not constitute an offer or a solicitation to buy or to sell any security, product or service in any jurisdiction; nor is it intended to provide investment, financial, legal, accounting, tax, or other advice and such information should not be relied or acted upon for providing such advice. This document is not available for distribution to investors in jurisdictions where such distribution would be prohibited.

RBC GAM is the asset management division of Royal Bank of Canada (RBC) which includes RBC Global Asset Management Inc., RBC Global Asset Management (U.S.) Inc., RBC Global Asset Management (UK) Limited, RBC Global Asset Management (Asia) Limited, and RBC Indigo Asset Management Inc. which are separate, but affiliated subsidiaries of RBC.

In Canada, this document is provided by RBC Global Asset Management Inc. (including PH&N Institutional) and/or RBC Indigo Asset Management Inc. which is regulated by each provincial and territorial securities commission with which it is registered. In the United States, this document is provided by RBC Global Asset Management (U.S.) Inc., a federally registered investment adviser. In Europe this document is provided by RBC Global Asset Management (UK) Limited, which is authorised and regulated by the UK Financial Conduct Authority. In Asia, this document is provided by RBC Global Asset Management (Asia) Limited, which is registered with the Securities and Futures Commission (SFC) in Hong Kong.

Additional information about RBC GAM may be found at www.rbcgam.com.

This document has not been reviewed by, and is not registered with, any securities or other regulatory authority, and may, where appropriate and permissible, be distributed by the above-listed entities in their respective jurisdictions.

Any investment and economic outlook information contained in this document has been compiled by RBC GAM from various sources. Information obtained from third parties is believed to be reliable, but no representation or warranty, express or implied, is made by RBC GAM, its affiliates or any other person as to its accuracy, completeness or correctness. RBC GAM and its affiliates assume no responsibility for any such errors or omissions.

Opinions contained herein reflect the judgment and thought leadership of RBC GAM and are subject to change at any time. Such opinions are for informational purposes only and are not intended to be investment or financial advice and should not be relied or acted upon for providing such advice. RBC GAM does not undertake any obligation or responsibility to update such opinions.

RBC GAM reserves the right at any time and without notice to change, amend or cease publication of this information.

Past performance is not indicative of future results. With all investments there is a risk of loss of all or a portion of the amount invested. Where return estimates are shown, these are provided for illustrative purposes only and should not be construed as a prediction of returns; actual returns may be higher or lower than those shown and may vary substantially, especially over shorter time periods. It is not possible to invest directly in an index.

Some of the statements contained in this document may be considered forward-looking statements which provide current expectations or forecasts of future results or events. Forward-looking statements are not guarantees of future performance or events and involve risks and uncertainties. Do not place undue reliance on these statements because actual results or events may differ materially from those described in such forward-looking statements as a result of various factors. Before making any investment decisions, we encourage you to consider all relevant factors carefully.

® / ™ Trademark(s) of Royal Bank of Canada. Used under licence.
© RBC Global Asset Management Inc. 2024

Publication date: September 15, 2024

32467 (09/2024)
EXECUTIVE SUMMARY-FALL 2024_E 09/16/2024