

# Investment UPDATE

## Many headlines. One clear message.

2007 was an eventful year filled with many investment news stories. Headlines relating to mergers and acquisitions, challenges in the U.S. housing market, record oil prices and the Canadian dollar achieving parity with the U.S. dollar gave investors a lot to think about. While much of this news contributed to greater uncertainty in the markets, it also served as a strong reminder that sticking with your long-term plan can greatly improve your probability of investment success in the long run.

Throughout the past year, the major events behind the headlines caused market movements to become more pronounced, which often makes investment decisions more difficult. This was particularly true in the latter half of the year as issues relating to U.S. subprime mortgages weighed on the minds of investors and volatility increased.

When markets fluctuate as they have recently, it's natural to take a closer look at your portfolio. As you review your statement, you may notice that the performance of your investments

over the past quarter reflects the challenges markets have faced during this time. What's important to remember is that when it comes to investing, success is not about what happens during any given day, month or quarter. Success is measured over longer periods of time and by whether your investments enable you to achieve your goals for the future.

As the chart on page 2 shows, investors experienced both highs and lows between July and December. While this volatility felt uncomfortable, what happened during this period highlighted the pitfalls of trying to

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## Many headlines. One clear message. *continued*

time the markets. Moving in and out of your investments in an effort to sidestep short-term events is a risky strategy because it's impossible to predict exactly what will happen next. That's why maintaining discipline has proven to be the best course of action over time.

While the outlook may be less clear than it was six months or even a year

ago, one message remains very clear amid this environment of up and down markets – staying invested, not timing the markets, is the best strategy for achieving your long-term goals.

As we head into 2008, communicating with your advisor will be particularly important in ensuring that you have the information you need in order to

make good investment decisions. Talk to your advisor if you have concerns, confirm that key elements like expert guidance and diversification have been built into your portfolio and stay committed to your long-term plan. These things will put you in a great position to succeed with your investments in any type of market.

**S&P/TSX Composite Index – 2007 Year in Review**  
The value of professional, active investment management



### Highlights from the past few months

**SEPTEMBER 18**

U.S. Federal Reserve slashes fed funds rate by 50 basis points – first rate cut since 2003.

**SEPTEMBER 20**

Canadian dollar reaches parity with U.S. dollar in intraday trading – the first time in 31 years.

**NOVEMBER 21**

Price of crude oil rises above \$97 per barrel U.S.

**DECEMBER 4**

Bank of Canada cuts key lending rate by 25 basis points to 4.25% – first cut in 3 years.

# New investment solutions from RBC Asset Management

As part of our ongoing commitment to providing you with solutions to help you meet your investment objectives, RBC Asset Management is proud to announce two new additions to the RBC Funds lineup.



**Best Overall Fund Group**  
RBC Asset Management

## RBC Premium \$U.S. Money Market Fund

- › With the Canadian dollar at near all-time highs, clients with U.S. dollars may be looking for better solutions.
- › This Fund is appropriate for investors with large U.S. dollar balances who are looking for liquidity combined with a higher yield compared to traditional U.S. dollar savings or money market accounts.
- › Available January 14, 2008 in RBC branches.

## RBC O'Shaughnessy U.S. Growth Fund II

- › The U.S. is home to many of the world's most successful and fastest growing companies. This Fund adheres to Jim O'Shaughnessy's disciplined, well defined investment strategy designed to select the best growth securities across U.S. equity markets.
- › Available February 18, 2008 in RBC branches.

**FOR MORE INFORMATION ABOUT THESE NEW FUNDS, SPEAK TO YOUR ADVISOR.**

## Bonus 1% on your GIC<sup>†</sup>

If you are a conservative or income oriented investor, Guaranteed Investment Certificates (GICs) may be an important part of your investment portfolio for the secure, stable returns they provide. To help you save for your investment objectives, we're offering a 1% bonus on 18-month and 3-year Non-Redeemable GICs. This 1% bonus is available until February 29, 2008.

To take advantage of this 1% bonus, talk to your advisor today. Your advisor will work with you and design a diversified portfolio to meet your investment objectives.

<sup>†</sup> Offer subject to change at any time.

## Your retirement is about more than numbers

At RBC, we don't start with the numbers, we start with you. Our advisors ask unexpected questions that get right to the heart of what's really important to you. An advisor can meet with you to understand your vision of retirement, and help you create a financial strategy that gets you there. After all, your retirement is about so much more than numbers.

To set up an appointment with an advisor, call 1-800-ROYAL®1-1 or visit [www.rbc.com/yourfuture](http://www.rbc.com/yourfuture).



## Market outlook

After climbing out from its August low and sprinting ahead following September's unexpectedly large 50-basis-point cut in the fed funds rate, the stock market plunged again in November against the backdrop of an intensifying credit crunch threatening to move beyond the commercial paper market and into the broader economy. That threat still exists and, left unchecked, presents a serious risk to the economic cycle.

We respect the stock market's message, and also that of the bond market, where a flight to quality has pushed 10-year T-bond yields down 50 basis points in the past month alone — this despite the challenge to fixed-income markets that usually comes with a falling fed funds rate. That said, we are not ready to abandon our baseline forecast of durable growth, mild inflation and low interest rates. There is simply not enough evidence that the slide into recession has begun, and less evidence that central banks are about to watch that happen without an even more aggressive response.

### **CREDIT CRUNCH THREATENS...**

The credit crunch remains a significant threat to the global economic expansion. The root of the problem, troubled sub prime loans backed by frequently impaired borrowers and a sliding housing market, defies an easy solution. The worst of the crisis, however, may be upon us now as the shakiest borrowers are quickly flushed out. A raft of proposals, and more that are certain to come, hold the prospect of limiting the fallout and distributing pain over a manageable time frame.

### **...BUT RISK OF RECESSION IS MILD**

Falling interest rates, firm job creation and a narrowing trade gap are holding the economy on a growth track in spite of the shock. As long as a more general credit crunch is avoided, the risk of recession appears mild.

### **A GRADUALIST APPROACH TO RATE CUTS**

The drums are beating for interest rate cuts, and the market wants them soon. We expect the Fed and other central banks to continue with a gradualist approach, feeding in cuts only when absolutely necessary, balancing the risk flowing from the credit crunch against the potential for inflation as the pressure eases, exposing the economy to stimulative rates without much excess productive capacity.

### **BOND YIELDS UNSUSTAINABLY LOW**

Plunging bond yields reflect an intense shift in risk premiums. Absent recession, current levels will be difficult to sustain, especially as central banks shift their bias toward future interest rate changes. Over the year ahead, we look for total returns either side of 0% for the world's major bond markets. In both the U.S. and Canada, we forecast 10-year yields rising to the 4.75% level.

### **EQUITIES SHOW GOOD POTENTIAL**

Equity markets lie close to or below their fair value in most of the world's major markets. Fair value is the minimum valuation level consistent with periods of durable growth, mild inflation and low interest rates. Moreover, the record for stocks during periods following an initial cut in the fed funds rate is almost always positive. We forecast gains in the low double digits over the year ahead for the major markets. Our regional mix is tilted toward U.S. equities as a result of both relative valuations and the emerging leadership of large cap, growth oriented stocks which dominate the U.S. list more than any other.

### **A BOTTOM FOR THE U.S. DOLLAR?**

A flight from risky assets has pulled most major currencies far above their purchasing power parity values. The U.S. dollar has been sold indiscriminately. It may be too early to call the end of this dollar bear market, but the risk/reward trade off for staying short the dollar against major currencies now appears very poor.

### **ASSET MIX TILTS TO STOCKS, AWAY FROM BONDS**

The outlook, which seemed so clear only six months ago, is decidedly murky. We acknowledge the accumulated threats to the cycle and are keenly reviewing any developments that tilt the balance of risks. We haven't seen enough of these to join all those fleeing to safe havens.

As a result, we've cut our exposure to bonds twice over the past quarter, pulling our fixed-income weight below the midpoint of its allowable range, while maintaining relatively full exposure to stocks.

*Provided by RBC Asset Management*

# The one-minute market update

## EQUITY MARKETS

- › After declining in August with the emergence of a “credit crunch”, equity markets recovered by mid-October and reached new highs. Markets fell again in November on concerns that these credit issues may threaten global economic expansion. At the root of the problem are troubled sub-prime mortgages issued to weak borrowers and a sliding housing market.
- › Despite these declines, we are not ready to abandon our baseline forecast of durable growth, mild inflation and low interest rates. There is simply not enough evidence that a slide into recession has

begun, and less evidence that central banks are about to watch that happen without cutting interest rates even more aggressively.

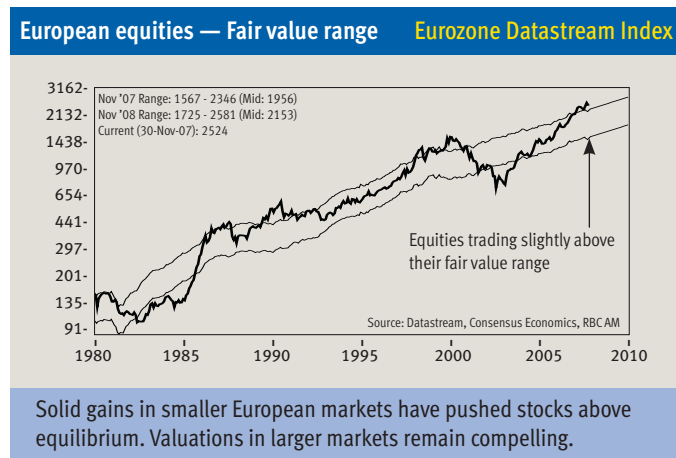
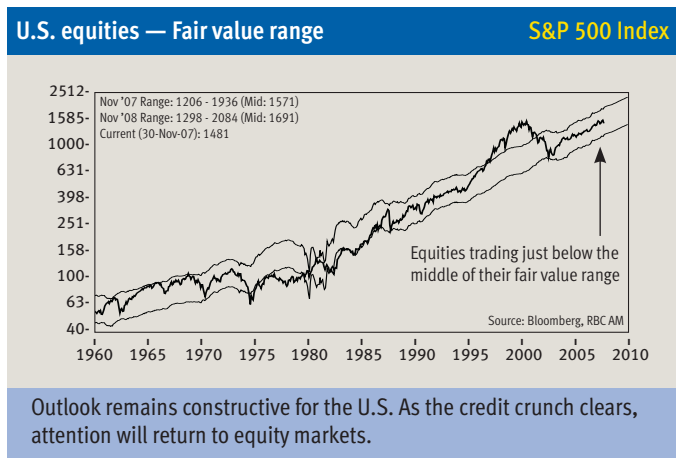
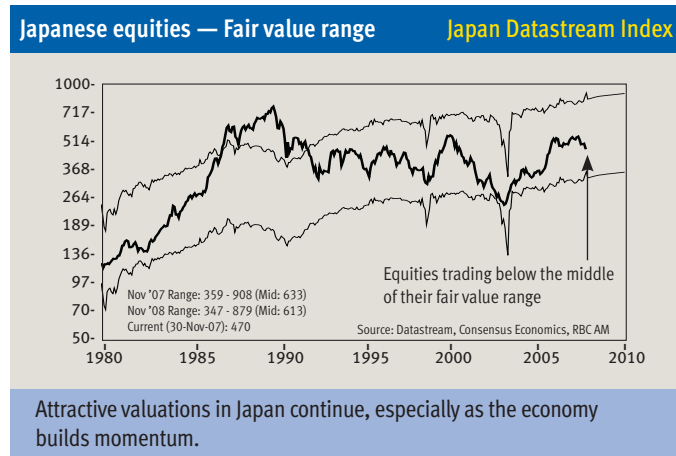
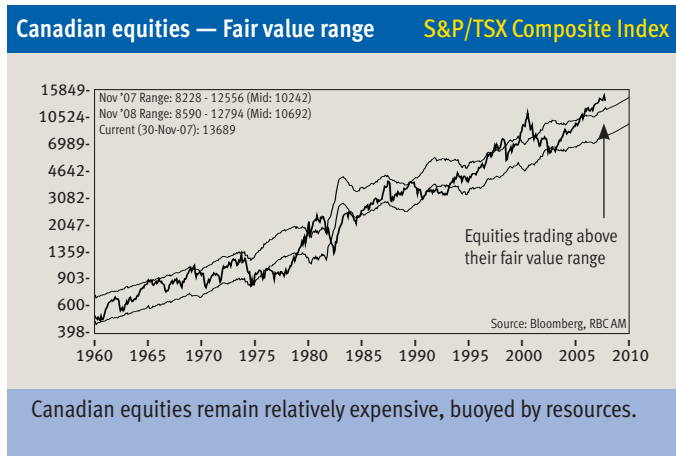
## FIXED INCOME MARKETS

- › Short term interest rates were reduced in the U.S. and Canada over the past quarter. Although these rate cuts typically have a negative impact on longer term bonds, concerns in the stock market saw investors seeking safety in fixed income, which led to a rally in November.
- › We believe bond prices will be difficult to sustain at current levels, and performance in the last month of 2007 seems to validate this view. We believe

that global bond markets remain significantly overvalued – and vulnerable – at current levels.

## IMPLICATIONS

- › Falling interest rates and firm job creation are holding the economy on a growth track in spite of recent turmoil. As long as the credit crunch is contained, the risk of recession appears mild.
- › For 2008, we forecast low double digit gains for equities in most major markets. Valuations lie close to or below fair value, which is the minimum level we would expect given today’s economic environment.



## Preparing for tax reporting

As an investor in RBC Funds or RBC Guaranteed Investment Certificates (GICs), you will receive early in the new year all of the information you need to accurately report for tax purposes any income you've earned from your investments during the past year if they are held in a non-registered investment account. For mutual funds held in non-registered accounts, your year-end

statement also includes adjusted cost base (ACB) information. The ACB is important because it determines if you will realize a capital gain or loss when you sell your investment.

Depending on the type of account you hold your investments in, the table below summarizes the tax slips you can expect to receive.

**For more information about how your RBC investments impact your taxes, please ask your advisor for a copy of our *Taxes and Investing in Mutual Funds* brochure or you can download it at [www.rbcam.com](http://www.rbcam.com).**

| Tax slip  | Account type               | Description   | Mailing date                 |
|---|----------------------------|---|------------------------------|
| T3 statement of trust income allocations and designations (and Relevé 16 in Quebec) | Non-registered mutual fund | Shows the interest, dividends, capital gains, return of capital and foreign income received from <b>mutual funds</b> during the year, as well as any foreign income taxes paid. Income that benefits from favourable tax treatment, such as amounts eligible for the enhanced dividend tax credit, are also clearly identified for you. | Late February                |
| T5 statement of investment income (and Relevé 3 in Quebec)                          | Non-registered GIC         | Shows the interest earned on <b>GICs</b> during the past year.  | Late February                |
| RSP contribution receipt  | Retirement Savings Plan    | Retirement savings plan tax receipts are issued for <b>contributions</b> used to purchase mutual funds and GICs within registered accounts, as well as for deposits to registered savings accounts.   | Late January or early March* |
| T4RSP   | Retirement Savings Plan    | Summarizes <b>withdrawals</b> from an <b>RSP</b> throughout the year as well as any withholding taxes applied to these withdrawals.   | Early February               |
| T4RIF   | Retirement Income Fund     | Summarizes <b>withdrawals</b> from an <b>RIF</b> throughout the year as well as any withholding taxes applied to these withdrawals.   | Early February               |

\* For contributions made between March 2 and December 31, 2007, receipts will be mailed in January. For contributions made between January 1 and February 29, 2008, receipts will be mailed in early March.

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