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Investment insights

To help you stay informed, RBC Global Asset Management regularly provides insights and forecasts on the global economy and capital markets, along with in-depth analysis of how certain investment trends may impact your portfolio.

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A focus on the fixed-income landscape

Understanding the new era of fixed-income investing

Bond yields rose meaningfully during the second half of 2016, which translated into negative returns for some segments of the bond market. In this article we focus on the basic principles of fixed-income investing and how a diversified mix of bond and equity funds, like RBC Managed Portfolios, can help reduce volatility through different market conditions.

A Rapid Rise in Rates: 10-Year U.S. Treasury Yield Curve



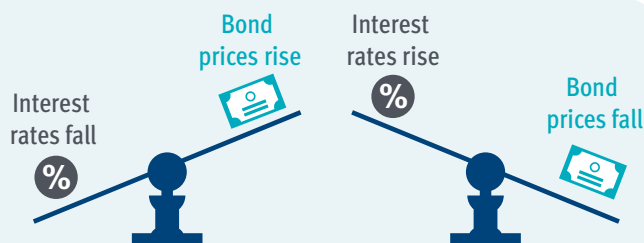
Source: Bloomberg

Bond basics

In its simplest form, a bond represents a financial obligation to pay a specified sum of money at specified future dates. Bonds are typically issued by governments and corporations. The issuer promises to make payments, which consist of interest in the form of regular coupon payments, and principal, which represents repayment of the initial amount borrowed.

Holding bonds in your portfolio can offer a number of benefits, such as providing a predictable source of income and helping to preserve capital as bond returns tend to be less volatile than equities. Although less prone to large changes in value, bonds are subject to risks of their own. Interest-rate risk is a primary risk facing investors in the bond market and is explained by the inverse relationship between the yield required by the

market and current bond prices. The price of a typical bond will change in the opposite direction of the change in interest rates (i.e. bond prices fall as yields rise).



For example, consider an existing bond with a coupon rate of 5%. If interest rates rise, any newly issued bonds will offer a higher coupon rate, for example 5.5%. The 5% bond will be less appealing to new investors and consequently its price will drop in order to remain competitive with the newer, higher-coupon bond.

Since the price of a bond fluctuates with market interest rates, an investor faces the probability that prices will decline in a rising interest-rate environment. The silver lining in this scenario is that coupons received from existing bonds can be reinvested in the newer bonds at higher rates.

Expanding the horizon for bonds

Investing in a rising-rate environment requires an appropriate allocation to fixed income and a broadly diversified basket of fixed-income holdings. As with equities, trying to gauge which bonds will outperform in any given year isn't a reliable approach.

By combining different types of bonds, from multiple geographic regions and issuers, interest-rate risk can be mitigated, as not all regions or sectors are at the same point in the economic cycle.

Fixed income within RBC Managed Portfolios

While the fixed-income component of RBC Managed Portfolios has been globally diversified for quite some time, we are continually exploring opportunities to further expand the breadth of the Portfolios through the addition of new funds into the lineup. The inclusion of global funds helps mitigate the risks of a rising interest-rate environment by adding exposure to markets outside North America.

At the asset mix level, RBC Managed Portfolios are actively monitored and tactically adjusted to position the Portfolios for the current environment and beyond. While all underlying fixed-income funds contributed positively to portfolio returns in 2016, our view is that the case for equities is more compelling. We remain underweight fixed income and overweight equities relative to the long-term strategic asset mix of each profile.

Building in fixed-income diversification

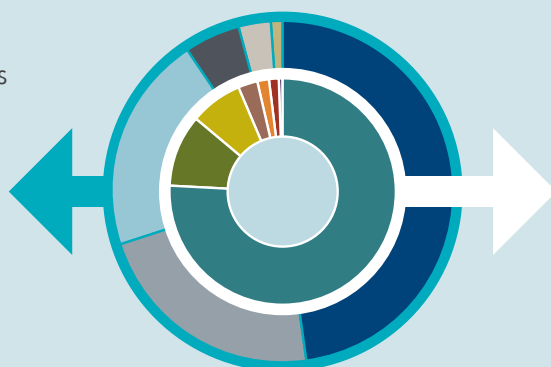
As the coming months unfold and interest-rate policy becomes interest-rate fact, we will continue to monitor and adjust your RBC Managed Portfolio to ensure your exposure to bonds is appropriate. We will continue to take full advantage of the breadth of available fixed-income offerings to help mitigate the risk of rising rates.

To learn more about fixed income in a low rate environment, visit RBC Global Asset Management's Current Perspectives webpage at rbcgam.com/investment-insights/current-perspectives.

RBC Managed Portfolio – Balanced Investment Profile: Breakdown of the Profile's fixed-income holdings

Sector

- 47.8% Investment Grade Corporates
- 22.2% Sovereign
- 20.7% Provincials
- 5.1% High Yield
- 3.1% Emerging Market
- 1.1% Other



Region

- 76.1% Canada
- 10.3% United States
- 7.4% Europe
- 2.6% Asia
- 1.7% Latin America
- 1.4% United Kingdom
- 0.5% Other

What happened in world markets last quarter



Fixed income

Global monetary policy continued to diverge. Most central banks remained focused on stimulating their economies with low interest rates and quantitative-easing commitments. On the other hand, the U.S. Federal Reserve – in light of firming inflation and strong employment gains – raised its benchmark-setting fed funds rate by a quarter percent in March. Bond yields rose sharply at the beginning of the quarter in anticipation of stronger economic growth and reduced monetary stimulus, before retreating at quarter-end in the face of U.S. public policy uncertainty. This quarter, the FTSE TMX Canada Universe Bond Index rose 0.33%, while the Citigroup World Government Bond Index (CAD\$ hedged) was down 0.05%.



Canadian equities

Stocks continued to add to their strong 2016 gains this quarter.

Equities rose on an improving if still uncertain outlook for oil and gas prices and clear signs of a strengthening U.S. economy. Financial shares were buoyed by stronger-than-expected results. Consumer spending and borrowing, and solid capital markets helped lift earnings. For the quarter, the S&P/TSX Composite Index increased 2.4%.



U.S. equities

Equities gained on expectations that the new Trump

administration would quickly introduce growth-stimulating economic policies, including cuts to personal and corporate taxes, increased infrastructure and military spending and reduced business regulation. Corporate earnings rose on increasing consumer spending and still-moderate wage growth, and banking stocks were lifted on rising margins and earnings prospects in the wake of increasing interest rates. The S&P 500 rose 5% this quarter.



International equities

Renewed optimism over European growth prospects – supported by signs of

increasing inflation, job gains and consumer spending – provided a positive tone to the region's bourses, while concerns over the rising popularity of far-right political parties in upcoming regional elections kept a lid on gains. The outlook for emerging market equities improved as the U.S. dollar retreated and the group's key export markets – Europe, the U.S. and China – showed increasing signs of growth. This quarter, the MSCI EAFE Index finished up 6.8% and the MSCI Emerging Markets Index added 10.9%.

All returns are in C\$. Canadian, U.S., MSCI EAFE and MSCI Emerging Markets index returns are total returns.



Portfolio Manager viewpoint

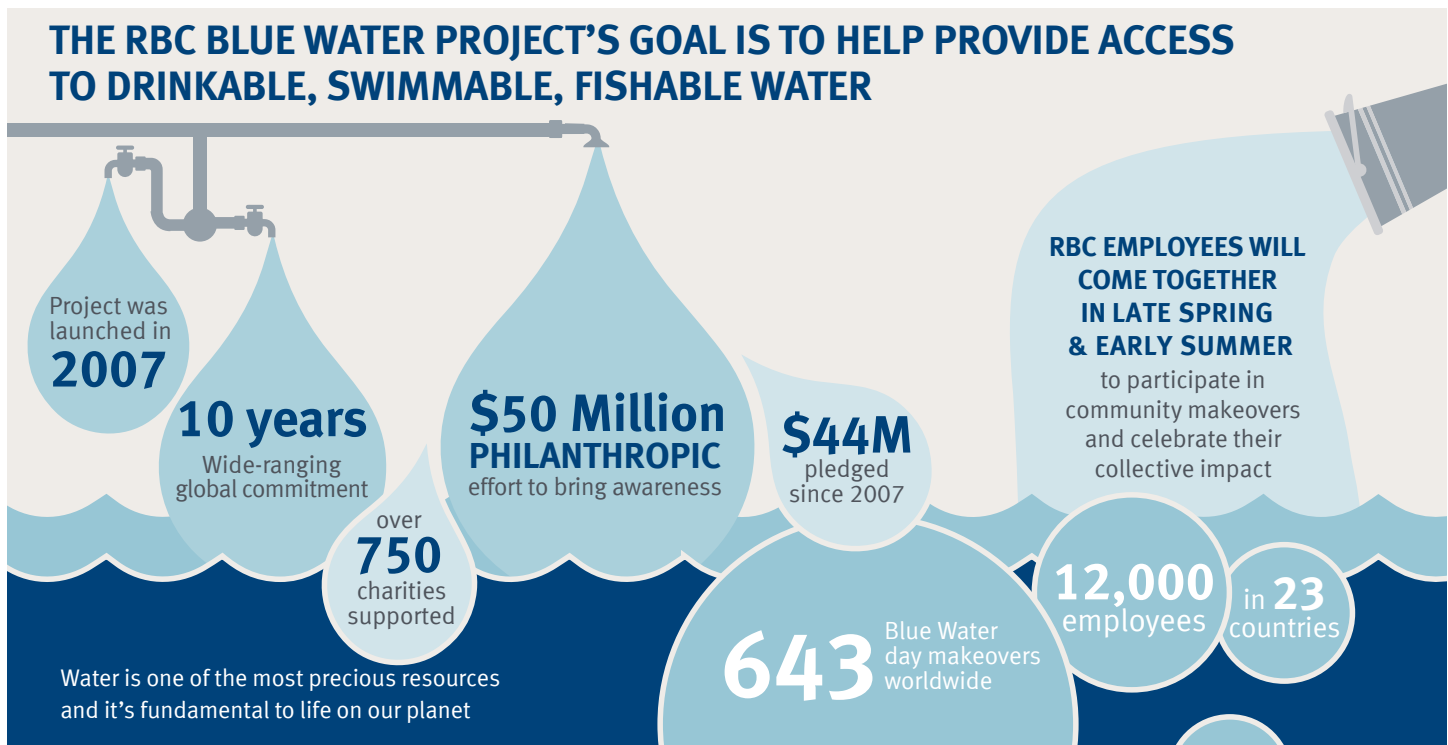
Sarah Riopelle, CFA, Vice President & Senior Portfolio Manager, Investment Solutions

Leading economic indicators are at their best levels in several years, economic surprises have been overwhelmingly positive and corporate earnings continue to recover from their prior stumbles. As a result, risk assets such as equities and corporate credit have performed well. Our expectation that yields will rise results in low or potentially negative returns over the years ahead so we remain underweight bonds. We don't think that equity valuations are as stretched as some investors believe, but we do recognize that stocks are not as cheap as they were, so a continued improvement in earnings is needed to fuel further equity gains. Prospective returns for equities are much more attractive relative to bonds so we remain overweight stocks in our asset mix. That said, we have slightly reduced our exposure to stocks due to the uncertainty surrounding U.S. public policy and a variety of style and technical factors.

RBC Blue Water Project makes a splash

This year, we are celebrating the 10-year anniversary of the RBC Blue Water Project, a global program dedicated to protecting the world's most precious natural resource – fresh water. The centrepiece of the RBC Blue Water Project is a \$50 million charitable commitment to support organizations that are working to protect water in our growing towns and cities.

On World Water Day, held on March 22, we announced the 2017 Blue Water Project grants and showcased stories of on-the-ground employee participation.



To learn more about the RBC Blue Water Project partnerships, employee involvement, impact and donations please visit: rbc.com/community-sustainability/environment/rbc-blue-water/about/index.html

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