

Insights

RBC Global Portfolios

Fall 2024



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Interest rates are dropping. What does this mean for your portfolio?

Canada, the U.S., and many other developed economies have begun cutting interest rates. While it's easy to see how this catalyst would affect rates on savings accounts, loans and mortgages, the effect isn't as obvious when it comes to investing.

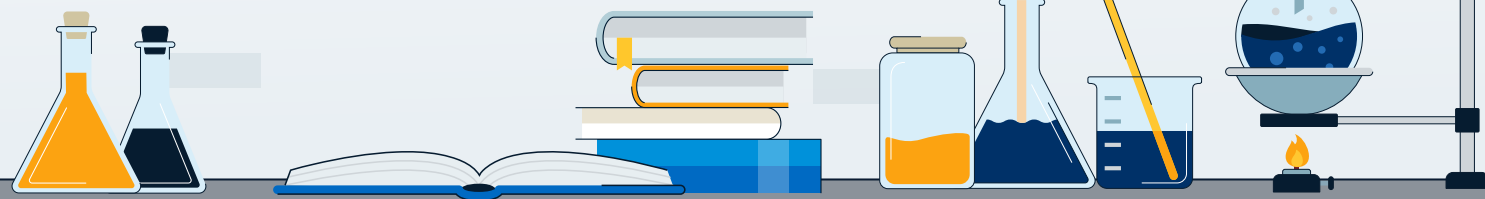
Historically, rate-cutting cycles have varied widely in both duration and degree of change. They tend to be shorter when cuts are made to combat inflation or to address global crises and tend to be longer when the economy falls into recession. What history shows us is that no matter how the rate cut cycle plays out, both stocks and bonds tend to benefit as interest rates fall.

In this edition of Insights, we explore the effect of rate cuts on your portfolio and how we think the current cycle will evolve.

No two interest cut cycles are the same
Past interest rate cutting cycles have varied in length and depth



Source: Federal Reserve Bank of St. Louis, Federal Reserve Economic Data. On Dec. 16, 2008, the U.S. Federal Reserve moved from a target rate to a target range. Rates post-Dec. 16, 2008 are represented by the midpoints of the range. Rate cutting cycles are defined as the following periods: Jun. 1989 to Sep. 1992, Jul. 1995 to Jan. 1996, Sep. 1998 to Nov. 1998, Jan. 2001 to Jun. 2003, Sep. 2007 to Dec. 2008, and Aug. 2019 to Mar. 2020.



What do interest rate cuts mean for your portfolio?

Interest rate cuts can have varying affects on stocks and bonds – the core elements of a diversified portfolio. These elements react differently to the state of the economy during rate-cutting cycles. Mixed into a diversified portfolio, they create a strong and stable solution.

Central banks cut interest rates to stimulate an economy. But the economy can slow without falling into a recession. After the recent period of rising rates, the current round of rate cuts is being enacted to encourage spending, help slow price appreciation, and prevent prices from rising too quickly again. This economic boost can help to avoid a recession.

How do stocks and bonds react to rate-cut cycles?



Stocks can be volatile. Stocks tend to provide strong returns in a no-recession rate-cut cycle as lower rates spur business investment, higher consumer spending and investor confidence. But if a recession occurs, corporate profits tend to fall and lead to lower returns over the short-term.



Bonds are typically more stable. Bonds tend to benefit from rate cuts, as bond prices rise when interest rates fall. But they perform well even when the economy stumbles, as investors tend to buy bonds as “safe haven assets”.

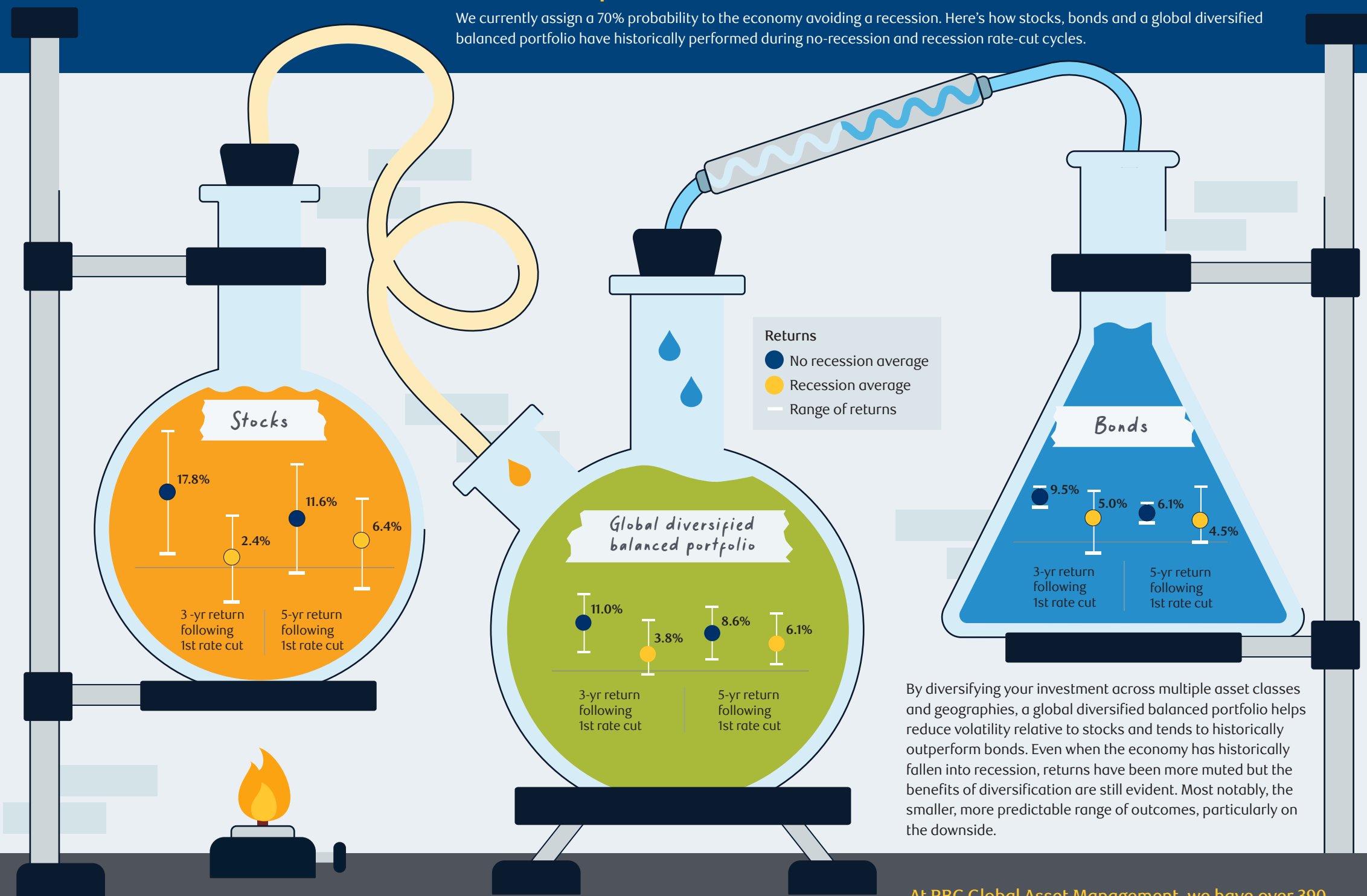
What do we expect from the current rate cycle?

With most central banks now cutting interest rates, we expect rates to continue to fall. The Bank of Canada has already cut rates three times. And the U.S. Federal Reserve delivered their first rate cut in September. We currently forecast 5-6 more U.S. rate cuts over the next 8-9 months.

While we’re budgeting for slow growth over the next several quarters, we still expect a soft landing, where the economy avoids a recession.

Rate-cut cycles during no-recession scenarios have led to better outcomes for both stocks and bonds - and have historically proven to be positive for a diversified portfolio.

We currently assign a 70% probability to the economy avoiding a recession. Here’s how stocks, bonds and a global diversified balanced portfolio have historically performed during no-recession and recession rate-cut cycles.



By diversifying your investment across multiple asset classes and geographies, a global diversified balanced portfolio helps reduce volatility relative to stocks and tends to historically outperform bonds. Even when the economy has historically fallen into recession, returns have been more muted but the benefits of diversification are still evident. Most notably, the smaller, more predictable range of outcomes, particularly on the downside.

At RBC Global Asset Management, we have over 390 investment professionals around the world keeping a close eye on market data such as interest rate movements to help keep your investments well positioned. The diversified approach of RBC Global Portfolios helps your portfolio navigate changes in the economy and markets - no matter what interest rates do.

Source: Morningstar Direct, RBC GAM. Bonds represented by Bloomberg U.S. Aggregate Bond Index. Stocks represented by S&P 500 Index. Global diversified balanced portfolio assumes monthly rebalancing as represented by 1.0% Cash, 39.0% Fixed income, 0.9% Canadian equities, 40.45% U.S. equities, 11.65% International equities and 7.0% Emerging market equities. Cash: FTSE Canada 30 Day T-Bill Index; Fixed income: FTSE WGBI Hedged CAD Index; Canadian equities: S&P/TSX Composite Index; U.S. equities: S&P 500 Index; International equities: MSCI EAFE Index; Emerging markets equities: MSCI Emerging Markets Index. All returns are total returns in Canadian dollars. Index returns do not reflect deduction of expenses associated with investments. If such expenses were reflected, returns would be lower. An investment cannot be made directly into an index. Returns are based on month end following the first rate cut in the last 6 rate cutting cycles. No recession rate cut cycles: Jul. 1995 to Jan. 1996, Sep. 1998 to Nov. 1998. Recession rate cut cycles: Jun. 1989 to Sep. 1992, Jan. 2001 to Jun. 2003, Sep. 2007 to Dec. 2008, and Aug. 2019 to Mar. 2020. An investment cannot be made directly into an index. Past performance is not a guarantee of future results.

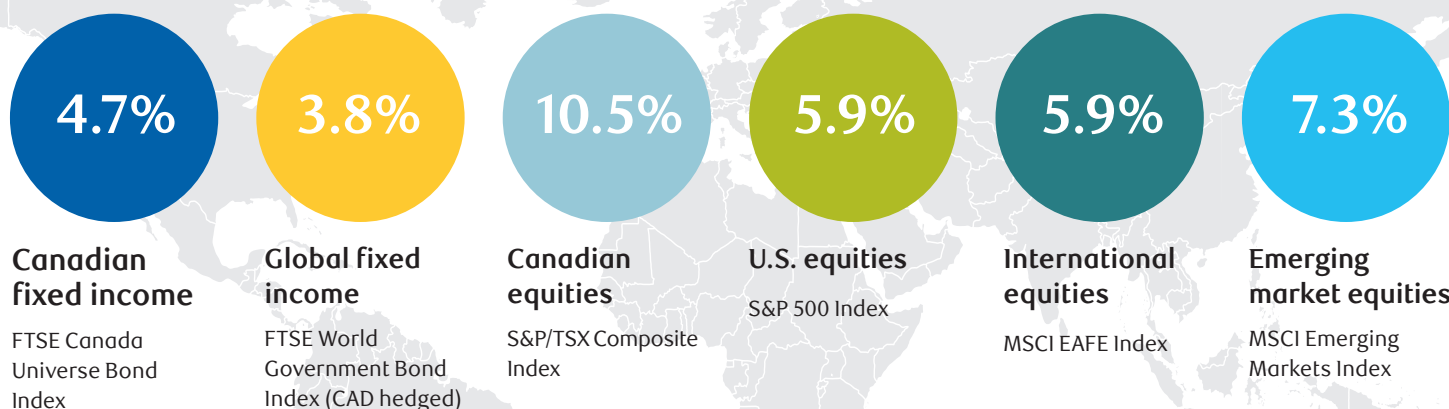


Portfolio manager viewpoint

Sarah Riopelle, CFA, Managing Director & Senior Portfolio Manager, Investment Solutions

The global economy is decelerating and, while a mild recession is possible given deterioration in labour markets, our base case remains for a soft landing as interest-rate cuts provide some relief. We believe bonds will offer less appealing returns absent a recession as 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 have reduced our fixed-income allocation this quarter to a slight underweight, moving the proceeds to cash. We opted against moving the funds into stocks given the potential for heightened volatility in the near term, as investors await additional clarity on the economy's trajectory. We would look to add to equities with more evidence of a soft landing and/or we observe a sustained shift in market leadership to smaller caps, value stocks and international equities.

Markets this quarter*



For our complete Fall 2024 Global Investment Outlook, please visit rbcgam.com/gio

*Source: Bloomberg. As of September 30, 2024. 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 Global Portfolios as part of your investment plan. If you have any questions or comments, please contact your advisor.

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