

Investment UPDATE

Summer 2022 edition

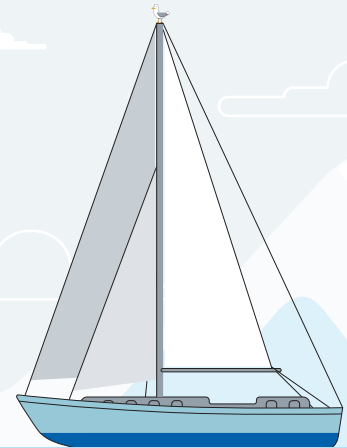


28263 (07/2022)

A long-term view of diversification

Diversification plays a role in many aspects of life. As children, we take a wide range of courses in grade school. In our working years, we often diversify our skill set. When we travel across Canada, we're able to enjoy the incredible biodiversity – oceans, lakes, mountains and more.

For investors, diversification means building a portfolio that holds different types of investments. This quarter we explore portfolio diversification, including the roles of cash, fixed income and equities. We also look at how a diversified portfolio has performed in times of rising interest rates and relative to long-term inflation.



3 reasons to diversify

Different investments have different return and risk profiles. Additionally, when market conditions change, some investments might go up in value, while others go down. How can a diversified investor benefit from factors like these?

1 The potential for smoother returns while generating strong long-term growth

2 The opportunity to build a portfolio aligned with short-, medium- and long-term goals

3 The ability to direct new investment dollars into the opportunities best aligned with your goals

How can diversification help smooth your investment journey?

This diversified portfolio delivered strong returns, but without the same degree of ups and downs as equity markets.

5-year market returns

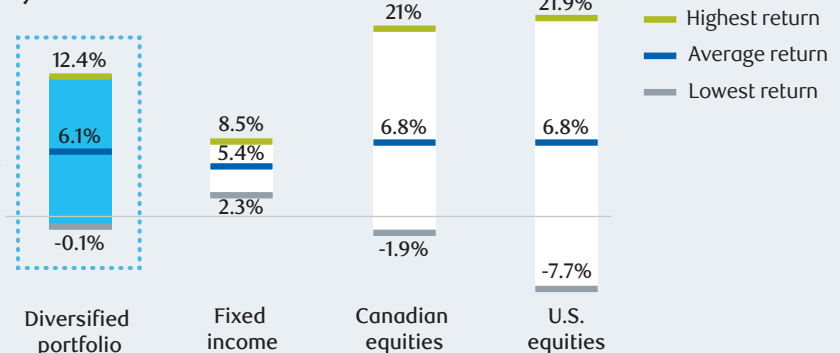


Chart source: Bloomberg, RBC GAM. 25-year period ended December 31, 2021. Based on five-year rolling returns, which means a new five-year return period starts each month. Please see footnote 1 on page 2 for additional details and disclosure on market returns and the Diversified portfolio.

A long-term view of diversification

On their own, cash, fixed income and equities play different roles



Cash and equivalents

Key benefits: Stability, liquidity and modest income

Typical goals: Shorter-term goals or an emergency fund



Fixed income

Key benefits: Steady income, relative stability and an income boost over cash

Typical goals: A mix of different bond types can help meet numerous short- and long-term goals



Equities

Key benefits: Potential long-term growth, income growth and inflation protection

Typical goals: Maximizing growth to meet longer-term goals

Together, fixed income and equities can help reduce portfolio ups and downs

In general, fixed income performs well when equities pull back. The reverse is also true.

↑ 5.8%

Average fixed income returns in years Canadian equities had negative returns

↑ 17.4%

Average Canadian equity returns in years fixed income had negative returns

Source: Bloomberg, RBC GAM. Based on calendar year returns from 1991-2021. Over this period, fixed income had negative returns in four years and Canadian equities had negative returns in 11 years. See footnote 1 for additional details on market returns.

The importance of taking a long-term view

As we have seen this year, there are times when both fixed income and equities struggle, putting a diversified portfolio to the test. While not uncommon on a monthly basis, a longer-term view can provide a more complete picture of the value of diversification.

For example, since 1991:

- 14% of monthly periods saw negative returns for both fixed income and Canadian equity markets – an average of about once every seven months.
- Only 1.4% of one-year periods saw both markets decline.
- There were ZERO three-year periods when both markets were negative.

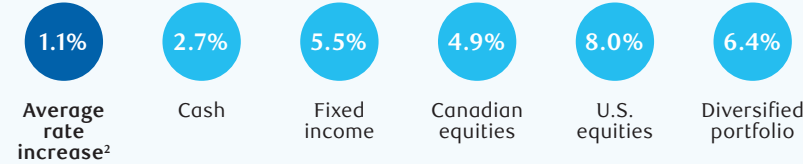
Source: Bloomberg, RBC GAM. January 1991 – April 2022. One-year and three-year periods are based on rolling monthly returns, which means a new return period starts each month. See footnote 1 for additional details on market returns.

¹ Unless otherwise noted, Cash represented by FTSE Canada 30 DAY T-Bill Index; Fixed income represented by FTSE Canada Universe Bond Index; Canadian Equities represented by S&P/TSX Composite Index; U.S. Equities represented by S&P 500 Index; International Equities represented by MSCI EAFE Index; Emerging Markets Equities represented by MSCI Emerging Markets Index. **Diversified Portfolio** assumes monthly rebalancing as represented by 2% Cash, 38% Fixed Income, 15% Canadian Equities, 25% U.S. Equities, 15% International Equities and 5% Emerging Markets Equities. Past performance is not a guarantee of future results. All returns are total returns in Canadian dollars, unless otherwise noted. 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 in an index.

Diversification can help when interest rates rise

When rates rise, investors tend to expect bond prices to fall (in line with higher borrowing costs) and stocks to perform well (as rates typically rise when the economy is strong). However, since 1991, in years when the Bank of Canada increased rates, cash, fixed income and equities have all maintained positive average returns.

Average market returns in years rates rose



Why is this important?

1. Rates rising are not necessarily a good predictor of market performance.
2. Diversification has been an effective way to navigate rising rates.

²Total of all rate increases minus decreases during the nine applicable calendar years divided by nine. Source: StatCan, RBC GAM. Based on the nine calendar years in which the Bank of Canada overnight rate was higher at the end of the year than it was at the beginning of the year from 1991-2021. See footnote 1 for additional details on market returns and the Diversified portfolio.

Diversification can help fight inflation

Despite today's higher inflation, the Bank of Canada remains focused on bringing inflation back to its target rate of 2%. From a long-term investment perspective, market returns have outpaced inflation since 1991, when the 2% target was set.

Average inflation and market returns since 1991

Inflation rate	Cash	Fixed income	Canadian equities	U.S. equities	Diversified portfolio
1.8%	2.7%	6.2%	8.8%	11.0%	8.2%

Why is this important?

Over the long term, a diversified portfolio has been an effective way to help build wealth and maintain purchasing power relative to inflation.

Source: StatCan, Bloomberg, RBC GAM. Inflation rate and market returns are annualized from 1991-2021. See footnote 1 for additional details on market returns and the Diversified portfolio.

How can you get the most out of diversification?

As with most investment strategies: take a long-term view, stick to your plan and avoid trying to time markets. Contact your RBC Advisor if you would like to discuss your investments.

Investing is now easier with **RBC Mobile**

- **NEW!** You can now make contributions to your existing mutual fund holdings or savings accounts anytime.

- As always, your balances and holdings are also at your fingertips.

To get started, click on any eligible account in your RBC Mobile app, or **download the app today.**

Talk to your RBC Advisor to learn more.

How can **MyAdvisor** help?

- Explore and monitor your goals
- Meet with an advisor
- Sign documents electronically

Log-in to RBC Online Banking to get started, or ask your RBC Advisor for a demo.



Economy



- This quarter we have reduced our 2022 forecast even further and now expect growth in 2023 to be the weakest in over a decade excluding the 2020 pandemic shock. We gauge that the risk of recession is high over the next two years.
- The key headwinds to the economy include extremely high inflation, aggressive central-bank tightening, a global commodity shock caused by Russian sanctions, supply-chain challenges and damage from China's zero-tolerance COVID-19 policy.
- Inflation pressures are broad-based but we expect them to calm as monetary and fiscal stimulus are dialed back, and commodity and housing price growth slows.
- We forecast 2.5% GDP growth in 2022 for the developed world, less than half the 5.2% rate achieved in 2021, followed by just 1.2% growth in 2023.

Fixed income



- The rapid and significant re-alignment of interest-rate expectations caused a fixed-income sell-off of historic proportions over the past year.
- Valuation risk has been significantly reduced and yields are now at much more reasonable levels, according to our models, which suggests that yields may not need to rise much beyond current levels once near-term inflation distortions pass.
- Our base case is that inflation ultimately moderates which means that the bulk of the needed adjustment in yields has already occurred. We forecast 2.75% on the 10-year yield 12 months from now, which would mean no further sustained capital losses for bond holders over the year ahead.

Equity markets



- Fear of inflation, aggressive monetary tightening and the increased risk of recession sent stocks lower in the past quarter and several major indexes fell into bear markets.
- Equity valuations fell from elevated levels, especially in high-priced technology stocks that were most sensitive to interest rates.
- If consensus estimates for profits come through, inflation pressures subside and investor confidence rebounds from extreme pessimism, stocks could deliver double-digit gains over the year ahead.
- But should a downturn or recession play out, history suggests that earnings could be vulnerable to declines of more than 20%, likely sending stocks lower.

For more investment insights please visit: rbcgam.com/market-insights

Connect with us



Book a phone or virtual appointment through MyAdvisor or RBC Online Banking

Call us toll-free at 1-800-463-3863

Visit us at rbcroialbank.com/investing



facebook.com/rbcroyalbank



twitter.com/@RBC



linkedin.com/company/rbc

Mutual Funds are sold by RMFI. There may be commissions, trailing commissions, management fees and expenses associated with mutual fund investments. Please read the Fund Facts/prospectus before investing. Mutual fund securities are not insured by the Canada Deposit Insurance Corporation. For funds other than money market funds, unit values change frequently. For money market funds, there can be no assurances that a fund will be able to maintain its net asset value per security at a constant amount or that the full amount of your investment in a fund will be returned to you. Past performance may not be repeated.

Investment and economic outlook information contained in the report has been compiled by RBC GAM from various sources and reflects our view on June 10, 2022. This document may contain forward-looking statements about a fund or general economic factors which are not guarantees of future performance. Forward-looking statements involve inherent risk and uncertainties, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement.

All opinions, estimates and forecasts contained in the report constitute our judgment as of the indicated date of the information, are subject to change without notice and are provided in good faith but without legal responsibility. The material in this newsletter is intended as a general source of information only, and should not be construed as offering specific tax, legal, financial or investment advice. Every effort has been made to ensure that the material is correct at time of publication, but we cannot guarantee its accuracy or completeness. Interest rates, market conditions, tax rulings and other investment factors are subject to rapid change. You should consult with your tax advisor, accountant and/or legal advisor before taking any action based upon the information contained in this newsletter.

MyAdvisor is an online platform from RBC where you can view your financial information including visual representations (charts and graphs) of your retirement readiness, net worth, cash flow, and financial goal tracking. You can also see how varying your current approach can affect your savings and goals. The MyAdvisor platform also enables you to book an appointment with an RBC advisor and to meet with your advisor using video chat or phone to open new accounts, including investment accounts, and get advice on meeting your financial goals.

Financial planning services and investment advice are provided by Royal Mutual Funds Inc. (RMFI). Investment advice provided by RMFI may be delivered through the MyAdvisor platform. RMFI, RBC Global Asset Management Inc., Royal Bank of Canada, Royal Trust Corporation of Canada and The Royal Trust Company are separate corporate entities which are affiliated. RMFI is licensed as a financial services firm in the province of Quebec.

FSC FPO

