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Investment UPDATE

Fall 2018 Edition

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A time-tested approach

Stocks and bonds both play an important role within a diversified investment portfolio. While both can provide income and help your portfolio grow, stocks are generally the main driver of long-term growth, whereas the key benefits of bonds include generating steady income and enhancing portfolio stability. Determining and maintaining the right mix of these two asset classes is an essential building block of investing success.

Over time, as market environments change, stock and bond markets can perform differently, and there will be periods when one outperforms the other. This sometimes causes investors to lose sight of the value of the underperforming asset class.

Recently, bond markets have been more volatile than usual, leading some investors to question the value of holding bonds in their portfolio.

While no one knows what the immediate future holds for bond markets, it's important to understand how bonds can benefit your portfolio.

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Time-tested reasons to maintain diversification

Maintaining a balanced approach through all markets can help manage portfolio risk and enhance long-term growth potential.

1994
Bond prices fell due to an unexpected increase in interest rates, leading many investors to remove bonds from their portfolio.

1995-1997
Canadian bonds delivered annualized returns of 14.1% over the next three years.†

1999
Investors flocked to tech stocks, while bonds, and even blue-chip stocks, were seen by many as a drag on portfolio growth.

2000
The tech bubble burst, with tech stocks falling 37% that year. On the other hand, Canadian bonds rose by 10.3%.†

2008
The financial crisis led many investors to move away from stocks, and into cash and bonds.

2018
The next decade saw Canadian, U.S. and global stocks rebound and reach new, all-time highs.

The role of bonds in your portfolio

Provide steady, reliable cash flow

Income from bonds has long provided investors with a stable income stream. And, despite low interest rates over the past decade, Canadian bonds continued to deliver year after year.

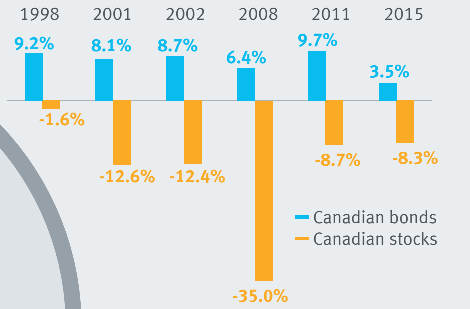
FACT

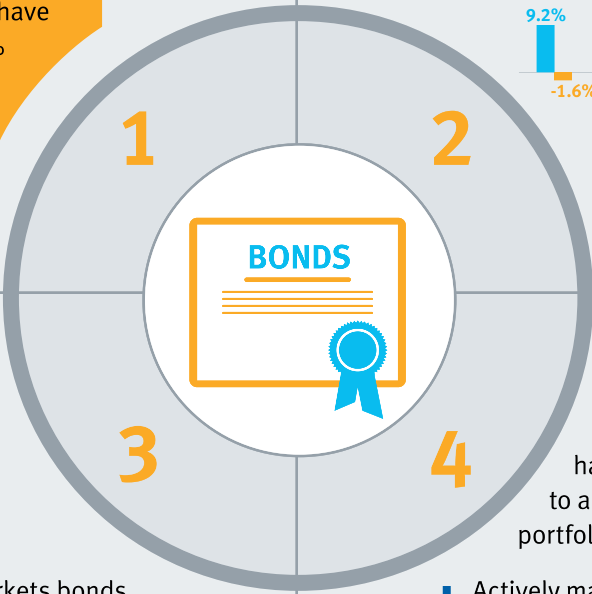
A $10,000 investment in Canadian bonds 10 years ago would have earned an average of 4.2% per year in income, or a total of $4,200[†].

Enhance portfolio stability

Bonds often act as a stabilizer in diversified portfolios. For example, there have been six calendar years with negative returns for Canadian stocks since 1998. In those specific years, Canadian bonds delivered an average return of 7.6%, helping many investors offset the volatility of stocks.

Bonds can help offset the volatility of stocks[†]





Portfolio diversification

Beyond the Canadian bond market, there are a wide variety of bond asset classes, each of which can provide several diversification benefits.

- U.S., global and emerging markets bonds can help lower portfolio volatility through geographic and currency diversification, and also offer a wide range of opportunities to help boost income
- High-yield and convertible bonds can enhance returns during periods of rising government interest rates, boost income and also help lower overall portfolio volatility

Growth potential

Within a diversified bond mutual fund, active managers have several tools they can use to add value and help grow your portfolio, including:

- Actively manage exposure to different bond asset classes, geographies and currencies
- Conduct deep credit analysis to identify and invest in high-quality holdings
- Buy shorter- or longer-term bonds to suit market conditions
- Seek out undervalued bonds with the potential for capital appreciation

Putting it all together

Over time, stock and bond markets will often outperform or underperform one another. While a recent period of volatility for bonds has some investors questioning their value in today's market environment, the key reasons to hold bonds in your portfolio – generating steady, reliable cash flow, and enhancing portfolio stability, diversification benefits and even growth potential – have not changed.

As an investor, having an appropriate asset allocation and sticking to your long-term investment plan remain key to your investing success.

Speak to your advisor today to learn more about the role of bonds in your portfolio.

[†]Source: RBC Global Asset Management. Canadian bonds = FTSE Canada Universe Bond Index; Canadian stocks = S&P/TSX Composite Index; Tech stocks = NASDAQ Index. All index returns in $CAD. An investment cannot be made directly into an index. The performance and income data 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.

Your fall financial clean-up

After the lazy days of summer, fall is a great time to simplify your finances ahead of a busy year-end. Here are a few tips to get organized before the holiday season rush.

Set up, or review, your pre-authorized contribution plan

A pre-authorized bi-weekly or monthly contribution to an investment account is a simple way to set up a pay-yourself-first savings plan. A regular contribution also eliminates the need for a Registered Retirement Savings Plan (RRSP) loan or the scramble to come up with a lump sum contribution each February for your RRSP.

Open a Tax-Free Savings Account (TFSA), or top it up

With the contribution room growing to almost $60,000 since its inception in 2009, the TFSA is an important, tax-efficient way to invest. Income and growth earned inside your TFSA are not taxable, and you can make tax-free withdrawals at any time, for any reason, providing both flexibility and tax advantages.

Turning 71 soon? Time to say good-bye to your RRSP

If you have an RRSP, you need to close it by December 31 of the year you turn 71. You have several options for winding it down, and an RBC advisor can help you make the choice that's right for you.

Help make a difference – set up a regular charitable contribution

Many Canadians donate to their favourite charities around the holiday season each year. While always appreciated, some charities struggle due to ongoing costs or heavy use of their services at different times of the year. As a result, many charities can greatly benefit from regular bi-weekly or monthly contributions.

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ONE-MINUTE MARKET UPDATE

For the full Fall 2018 Global Investment Outlook, please visit rbcgam.com/gio.

ECONOMY

- Led by the U.S., global economic growth is running at an above-average pace, but many other major economies are slowing.
- Protectionism, China's economic deceleration and the aging business cycle are among the key risks that threaten our base-case view of solid, albeit moderating, economic growth.
- While we expect the global economy to continue expanding, the mild slowdown in economic momentum since the start of the year led us to lower our developed-world growth forecasts slightly and they are now mostly below consensus. Our emerging-market growth forecasts are also below the consensus estimate.

FIXED INCOME

- In response to strengthening labour markets and firming inflation, central banks have continued a gradual tightening of monetary policy.
- Our model assumes that real, or after-inflation, interest rates will revert to their historical norms over the next half-decade and that the increase is distributed evenly over time.
- A sustained period of rising yields would act as a headwind to bond returns for many years.
- We remain underweight fixed income, but are holding a larger position than we have in the past since bonds should provide a cushion in a balanced portfolio in the event of a recession and/or deterioration in the outlook for corporate profits.

EQUITY MARKETS

- Global equities were mixed over the quarter, with the S&P 500 Index rising to an all-time high while many other markets posted negative returns.
- Stocks can deliver decent upside with reasonable assumptions but earnings growth is now critical to sustaining the bull market.
- We remain overweight equities, as we think economic growth will be sufficient to drive further gains in corporate profits and revenues.
- Given the aging business cycle and the fact that U.S. equities are above fair value, we are holding less exposure to stocks than we have at earlier points in the bull market, and caution investors to expect lower total returns and heightened levels of volatility over the coming quarters.

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