Staying ahead of inflation

More than a year into the pandemic, shortages and pent-up demand from lockdowns have put upward pressure on the prices of many goods and services. Enter inflation. This quarter, we break down the forces behind inflation and how the diversified nature of your portfolio keeps you well protected.

What is inflation?

Put simply, inflation is the increase in prices over time. The inflation rate measures how prices have changed over a period of time.

Cost of a dozen eggs over the years

$1.47 in 1991

$3.80 in 2021

$4.63 in 2031

1Source: Statscan, Bank of Canada as of May 2021. 2Source: Statscan, Bank of Canada. 3Calculated using projected annual inflation of 2%.

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What’s the outlook for inflation?

RBC Global Asset Management believes today’s higher inflation will likely be temporary as markets work through the effects of the pandemic. Some inflation signals have peaked and begun to edge back down in both the United States and Canada. While inflation may be higher over the next few months, it’s likely to run only moderately above 2% over the next few years. Over the long term, several forces will likely keep inflation in check:

- **Technology**: The rate of technological progress should continue to increase productivity and output – providing ample supply for many in-demand goods and services.
- **Demographics**: Slower population growth and an aging population should also work to reduce demand and, in turn, prices.

Low starting point

Inflation is relative. Today’s prices have risen more significantly because of last year’s pandemic-induced lows. The lockdowns of last spring resulted in store closures and lower demand for goods and/or services. This drove last year’s comparable prices down.

Government fiscal stimulus

Record government stimulus has increased the amount of money available to consumers and many Canadians are starting to spend. If consumer demand outpaces supply, it can push prices higher.

Central banks

Around the world, many central banks have stated they intend to let inflation run slightly higher than average before adjusting interest rates higher in response.

### Inflation affects asset classes differently

Inflation can affect some asset classes more than others. A well diversified portfolio can help you stay ahead of inflation and reduce its impact on your overall wealth.

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Investment returns</th>
<th>After inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>2.2%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Bonds</td>
<td>3.1%</td>
<td>7.8%</td>
</tr>
<tr>
<td>Equities</td>
<td>16%</td>
<td>6.0%</td>
</tr>
</tbody>
</table>

**EXAMPLE: The cost of a 500 sq ft deck**

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost of wood (USD)</th>
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<tr>
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Lumber prices have fallen from their record highs in May, spurred by the economic reopening and an increase in production.

### What’s driving inflation?

Here are some of the reasons inflation has trended higher since the start of this year.

- **Summer 2021 | Insights RBC Select Portfolios**

Inflation is just one of the many economic forces that can affect your investments. If you’d like to review your portfolio, or if your goals or personal situation have changed recently, contact your financial advisor.

### Why are lumber prices through the roof?

#### How much the price of lumber has increased over the past year

**383%**

A pandemic-induced home renovation boom, combined with production delays contributed to a surge in price.

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### How do RBC Select Portfolios protect you as an investor?

Through broad diversification, your investment in RBC Select Portfolios can help you stay ahead of inflation. With over 30+ years of asset allocation experience, our investment experts here at RBC Global Asset Management keep your portfolio well positioned as economic and market conditions change.

### Inflation can impact bonds, so diversification is key

Inflation and interest rates tend to move in the opposite direction from bond prices. When they rise, it can reduce the value of your bond holdings.

While inflation may impact areas of the bond market in the near term, bonds play an important role in diversified portfolios by providing stability against equity market volatility.

#### Equities tend to protect investors against inflation

Company revenues, and therefore earnings, can outpace inflation over time.

Over the last 20 years, equities have delivered returns approximately 6% higher than inflation.

### Why are lumber prices through the roof?

- **Cost of wood May 2020**
- **Cost of wood May 2021**

Lumber prices have fallen from their record highs in May, spurred by the economic reopening and an increase in production.

1. **Source: Bloomberg April 2021**
2. **Source: Nasdaq, Lumber prices (LBS) as of May 7th 2021.**
3. **Source: Morningstar Direct, RBC GAM for 20-year Investment returns data as of June 28, 2021. For illustrative purposes only. Cash: FTSE Canada 30 Day T-Bill Index. Bonds: FTSE Canada Universe Bond Index. Equities: S&P/TSX Composite TR Index. The indicated rates of return are the historical annual compounded total returns for the periods indicated including changes in unit value and reinvestment of all distributions. 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. Source: Bank of Canada for average inflation data as of June 28, 2021. Inflation is approximated by the change in Consumer Price Index (CPI) each month.**

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Portfolio manager viewpoint

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

The latest wave of COVID-19 infections is now retreating, allowing governments to incrementally reopen their economies. We anticipate rapid growth in 2021, followed by slower but still good growth in 2022. Risks include further waves of virus infection, fiscal hangover in 2022, withdrawal of central bank stimulus, and high inflation. Bond yields paused after a massive rise earlier in the year. We see yields peaking at levels not far above current levels in the shorter term and, as a result, expect low returns in sovereign bonds. Strong growth, surging corporate profits and elevated investor confidence have helped to extend the bull market and boost global equities to record highs. We think a significant overweight in equities is appropriate in this environment. That said, we recognize U.S. equity valuations are now full and have therefore trimmed our overweight equity exposure by 50 basis points from last quarter, sourced entirely from U.S. equities.

Markets this quarter

1.7% 0.7% 8.5% 7.1% 3.8% 3.6%

Canadian fixed income
Global fixed income
Canadian equities
U.S. equities
International equities
Emerging market equities

FTSE Canada Universal Bond Index
FTSE World Government Bond Index (CAD hedged)
S&P/TSX Composite Index
S&P 500 Index
MSCI EAFE Index
MSCI Emerging Markets Index

For the complete Summer 2021 Global Investment Outlook, please visit rbcgam.com/gio

We thank you for your ongoing trust in continuing to hold RBC Select Portfolios as part of your investment plan. If you have any questions or comments, please contact us or your advisor.

> Call 1-800-463-3863
> Email funds.investments@rbc.com
> Visit rbcgam.com

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