OCTOBER 2014

THE CORRECTION HAS ARRIVED

A special report by the Portfolio Advisory Group

There's Wealth in Our Approach.™

Jim Allworth - *Chief Investment Strategist, RBC Dominion Securities Inc.*
Matt Barasch - *Head of Canadian Equities, RBC Wealth Management Portfolio Advisory Group*

Priced as of October 15, 2014, unless otherwise stated.
For important disclosures see Page 5 and 6.
All values in CAD unless otherwise stated. All performance figures from Bloomberg unless otherwise stated.
Not for distribution in the U.S.

RBC Wealth Management
Dominion Securities

The Correction Has Arrived

After more than 1,100 days, the long-awaited equity market correction appears to be upon us. While the narrative for much of the past two years has centered around investors' desire for a correction of some magnitude, so as to create the proverbial "buying opportunity", when these things finally arrive, they often come very quickly and violently and feel nothing like a buying opportunity. We believe that while this market correction may have some days or even weeks left to run, the overriding backdrop by our reckoning is little changed and remains supportive of higher stock prices in the intermediate to longer-term.

Global growth is slowing, but U.S. outlook continues to improve

While U.S. stock markets have corrected ~10% (more so for midcaps and small caps) since peaking in mid-September, the global picture has not changed very much.

Europe: To be blunt, Europe remains a significant drag on the global outlook, but this is not new news and we believe that at least directionally, policymakers are taking the right steps to combat growth weakness. The ECB appears ready to embark on a quantitative easing program that we believe could have a positive effect on lending and eventually growth in region.

Asia: Chinese growth has slowed from 10%+ a few years ago to around 7% today. Further, the nature of this growth has changed as China is in the midst of altering its growth mix from one dependent on investment to one driven more by consumption. This transformation will take many years to play out and we believe will eventually make China more stable albeit slower growing. In the interim, China will not be the contributor to global growth that is has been. This has already become especially acute within the commodity sector as not only is China growing at a significantly slower pace than in past years, but also consumption driven growth is less "commodity-centric" than are capital investment and infrastructure build-out. This obviously creates a headwind for more commodity heavy economies such as Canada, Australia and many emerging markets.

United States: Against this backdrop, the U.S. narrative continues to improve. The U.S. economy is relatively insulated from global growth concerns as U.S. exports comprise a relatively small part of the economy, while the U.S. economy generally benefits from lower commodity prices. The U.S. consumer balance sheet has improved markedly over the past six years with measures of debt-to-disposable income at decade lows and savings rates continuing to gradually rise. Further, the U.S. economy has created an average of more than 225,000 jobs per month this year and while wage growth has been muted, most surveys suggest that the jobs picture is becoming tighter, which we believe will translate into wage growth in the coming quarters. Add to this the sharp decline in gasoline prices, which acts as a de facto tax cut for consumers, and the stronger U.S. dollar, which can have a similar effect via lower import prices, and we believe the U.S. set up remains constructive.

Headline Risks are High

While the stock market often has to scale the proverbial "wall of worry", that wall seems particularly high at the present time:

- Ukraine: This situation remains an ongoing source of uncertainty and instability and has had a significant negative impact on eurozone sentiment.
- The Middle East: The rise of ISIS in Iraq has raised the risks that the U.S. may once again get pulled into an open-ended conflict in the Middle East.
- Ebola: Ebola has already wreaked a terrible toll on West Africa with a vector of cases now popping up in the United States. While the likelihood of a widespread outbreak in the developed world is very low, based on mathematical projection models, the number of cases in West Africa is likely to grow into the hundreds of thousands or even millions before the outbreak is contained.

What does this mean for stocks?

We wrote back in May about the nature of stock market corrections. We broke down market corrections into three buckets:

- Mild corrections, which we defined as 5% to 10% pullbacks tend to occur about once per year and take about one month to reach a bottom and a further two months to see the market recover to its prior highs.
- Intermediate corrections, those between 10% and 20%, tend to occur about once every 2 to 3 years and take about four months to reach a bottom and a further four months for the market to recover to its prior highs.
- Bear markets, which we defined as declines of greater than 20%, occur about once per decade and take about 18 months to reach a bottom and a further 26 months for the market to recover to its prior highs.

As we wrote then and would once again reiterate, bear markets are almost always associated with a U.S. recession. We continue to rate U.S. recession risks as very low, especially because the usual precursors of such an extended economic downturn are nowhere in evidence. Rather, we believe the current correction is very likely to fall into either the "mild" or "intermediate" categories, where the selloff is generally very swift and the recovery often just as rapid.

We have been here before

We would note that while the past few weeks have felt especially perilous, we have seen similar periods of angst over the past 51/2 years. In fact, since the market last had a correction of greater than 10%, there have been six "mild corrections", which have lasted between 13 and 42 trading days with each carrying their own unique set of worries. Further, if we go back to the March 2009 lows, we have experienced corrections of 16% and 19%, both of which in retrospect were fantastic long-term buying opportunities.

5%+ Corrections since October of 2011			
Start Date	**End Date**	**% Decline**	**# of Trading Days**
10/28/2011	11/25/2011	9.8%	19
4/2/2012	6/1/2012	9.9%	42
9/4/2012	11/15/2012	7.7%	42
5/21/2013	6/24/2013	5.8%	23
1/15/2014	2/3/2014	5.8%	13
9/18/2014	10/15/2014	7.4%	19
Median		***7.6%***	***21***
Source: Bloomberg			

Recommendation

We believe the correct approach for investors is to build a list of good businesses with sustainable, superior earnings growth, which often command a premium price that usually makes them appear expensive. Corrections usually produce some price weakness even for these outperformers and provide a rare opportunity to buy them "on sale." Identifying these high-quality targets in advance is part of the discipline required to capitalize on such opportunities when they arise, which is usually when others are fleeing for the exits. We believe such a situation is currently unfolding and investors with a willingness to look through some of the short-term whipsaws of the market will be rewarded in the long run.

Important Disclosures

This document is produced by RBC Wealth Management's Portfolio Advisory Group. The RBC Wealth Management Portfolio Advisory Group provides support related to asset allocation and portfolio construction for the firm's investment advisors / financial advisors who are engaged in assembling portfolios incorporating individual marketable securities.

Explanation of RBC Capital Markets High Yield rating system

An analyst's 'sector' is the universe of companies for which the analyst provides research coverage. Accordingly, the rating assigned to a particular issue represents solely the analyst's view of how that issue will perform over the next 12 months relative to the analyst's sector average. Top Pick (TP): Represents the analyst's best ideas in the Outperform category; provides best risk-reward ratio and/or is expected to significantly outperform its sector over 12 months. Outperform (O): Provides superior relative risk-reward ratio and/or is expected to materially outperform the sector average over 12 months. Sector Perform (SP): Provides an adequate relative risk-reward ratio and/or the total return is expected to be in line with the sector average over 12 months. Underperform (U): Provides an inferior relative risk-reward ratio and/or total return is expected to materially lag the sector average over 12 months.

Distribution of ratings

For the purpose of ratings distributions, regulatory rules require member firms to assign ratings to one of three rating categories - Buy, Hold/Neutral, or Sell - regardless of a firm's own rating categories. RBC Capital Markets' ratings, determined on a relative basis (as described above), correspond to these categories.

Distribution of Ratings
RBC Capital Markets, Equity Research
As of 30-Sep-2014

			Investment Banking Serv./Past 12 Mos.	
Rating	**Count**	**Percent**	**Count**	**Percent**
BUY[TP/O]	858	52.35	308	35.9
HOLD[SP]	683	41.67	151	22.11
SELL[U]	98	5.98	8	8.16

Conflicts policy

RBC Capital Markets Policy for Managing Conflicts of Interest in Relation to Investment Research is available from us on request. To access our current policy, clients should refer to https://www.rbccm.com/global/file-414164.pdf or send a request to RBC Capital Markets Research Publishing, P.O. Box 50, 200 Bay Street, Royal Bank Plaza, 29th Floor, South Tower, Toronto, Ontario M5J 2W7. We reserve the right to amend or supplement this policy at any time.

Dissemination of Research

RBC Capital Markets endeavours to make all reasonable efforts to provide research simultaneously to all eligible clients. RBC Capital Markets' equity research is posted to our proprietary websites to ensure eligible clients receive coverage initiations and changes in rating, targets and opinions in a timely manner. Additional distribution may be done by the sales personnel via email, fax or regular mail. Clients may also receive our research via third party vendors. Please contact your investment advisor or institutional salesperson for more information regarding RBC Capital Markets research.

Important Disclosures

As this is a compendium report, RBC Dominion Securities may choose to provide specific disclosures for the subject companies by reference. To access current disclosures, clients should send a request to RBC Dominion Securities, Attention: Manager, Portfolio Advisory Group, 155 Wellington Street West, 17th Floor, Toronto, ON M5V 3K7.
RBC Capital Markets Conflicts Disclosures.

RBC Wealth Management
Dominion Securities