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Insight

RBC Wealth Management

Perspectives from the Global Portfolio Advisory Committee

January 2024

# Global Insight 2024 Outlook highlights: Bonds are back

Whether the U.S. economy will tip into recession and with the return of bonds as an attractive complement to stocks, investors have much to consider in 2024.

Frédérique Carrier | Page 4

## Also in this issue

GLOBAL EQUITY

**More to come**

GLOBAL FIXED INCOME

**The subtraction of all fears**

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GLOBAL

# Insight

January 2024

# Contents

## 4 Global Insight 2024 Outlook highlights: Bonds are back

Whether the U.S. economy will tip into recession and with the return of bonds as an attractive complement to stocks, investors have much to consider in 2024.

## 8 Global equity: More to come

Our view laid out in the Global Insight 2024 Outlook is unchanged. We expect new highs in most major stock markets early this year, most likely followed by a U.S. recession.

## 9 Global fixed income: The subtraction of all fears

As the fear of inflation dissipates, along with other concerns that hung over fixed income markets in 2023, we look at what investors can expect from what should be a lower rate environment in 2024.

## In the markets

**3** RBC's investment stance

**8** Global equity

**9** Global fixed income

**11** Key forecasts

**12** Market scorecard

All values in U.S. dollars and priced as of market close, Dec. 31, 2023, unless otherwise stated.

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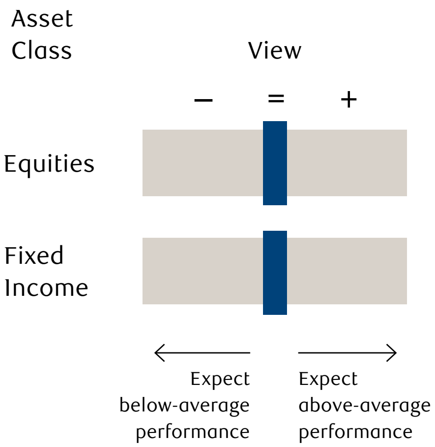
## RBC'S INVESTMENT Stance

### Global asset class views



(+/=/–) represents the Global Portfolio Advisory Committee's (GPAC) view over a 12-month investment time horizon.

**+ Overweight** implies the potential for better-than-average performance for the asset class or for the region relative to other asset classes or regions.

**= Market Weight** implies the potential for average performance for the asset class or for the region relative to other asset classes or regions.

**– Underweight** implies the potential for below-average performance for the asset class or for the region relative to other asset classes or regions.

Source - RBC Wealth Management

### Equities

- Equity markets surged recently, finishing 2023 firmly in positive territory with the S&P 500 up 24.2% and the MSCI All Country World ex-USA up 12.6% for the full year. While seven large U.S. technology-oriented stocks dominated 2023 returns, starting in late October performance began to broaden out to other U.S. and global sectors such as Real Estate, Financials, and Industrials, which outperformed their respective indexes late in the year.
- We still think equity returns in 2024 will largely depend on whether the U.S. economy succumbs to recession or achieves a soft landing. The year-end rally seems to be indicating the latter scenario. Our leading economic indicators, however, continue to send mixed messages, and there is evidence that the lagged effect of the Fed's aggressive rate hike campaign could, at the very least, dampen U.S. consumer spending and GDP growth in the quarters ahead.
- We would maintain Market Weight positioning in equities overall, which attempts to balance the risks of a U.S. recession against the possibility that one may be averted. We recommend tilting portfolios toward higher-quality segments of the equity market, including those companies with resilient balance sheets, sustainable dividends, and reliable cash flow generation.

### Fixed income

- Global yields have quickly retreated from the 2023 highs achieved in October when the average yield on the Bloomberg Global Aggregate Bond Index peaked at 4.4%. It opened 2024 at 3.5%. With the global inflationary backdrop rapidly improving, we think traders are looking for a quick pivot to rate cuts by most major central banks this year. Though yields on offer have dropped dramatically, they remain well above the averages of the past 20 years and continue to offer relatively attractive entry points, in our opinion.
- We remain Market Weight U.S. fixed income with yields remaining above multi-decade averages. While economic risks have subsided in the U.S., global recession risks remain elevated and credit valuations remain rich, in our view. Therefore, we broadly remain Underweight corporate credit with a slight bias toward government bonds.

MONTHLY

## Focus

# Global Insight 2024 Outlook highlights: Bonds are back

**Frédérique Carrier**
London, UK
frederique.carrier@rbc.com

Whether the U.S. economy will finally tip into recession and with the return of bonds as an attractive complement to stocks in a portfolio, investors have much to consider this year. Our 2024 Outlook examines the opportunities and challenges facing markets and asset classes in 2024.

## Market overview: A new reality

We think a U.S. recession is the most probable outcome in the coming quarters. In the past, the combination of high interest rates and restrictive bank lending standards—what is in place today—has been a recipe for recession. Soft landings, on the other hand, have historically featured rising interest rates but no overt tightening of lending standards. The presence of similar conditions, i.e., high rates and restrictive lending, is already taking a toll in Canada, the UK, and the eurozone.

However, it could be that the big, decisive shifts in fiscal and monetary policy over the past few years continue to have lingering effects on the course of the U.S. economy, and that instead of a decline in GDP, growth is merely on the slow side in 2024.

Regardless of the outcome, the economic headwinds which have been gathering will likely run their course and probably fully dissipate later in the year.

That could be enough to keep S&P 500 earnings growing, and we believe any growth in earnings would leave room for share prices to advance between now and the end of 2024, even if the path for getting there is debatable.

We recommend a Market Weight position in global equities, but we believe investors should consider limiting individual stock selections to high-quality businesses, i.e., those with resilient balance sheets, sustainable dividends, and business models that are not intensely sensitive to the economic cycle.

In our opinion, portfolios that have held their value to a better-than-average degree will be best equipped to take advantage of the opportunities that are bound to present themselves when a stronger pace of economic growth reasserts itself.

The stock market will need to adjust to the new competition from bonds for investment dollars. For the first time in more than a decade, bond yields have moved back up to levels that make fixed income a fully useable and attractive adjunct to equities in a balanced portfolio. Bonds provide, as they have traditionally done, a combination of reduced volatility, more predictable returns, and the comfort of a maturity value.

If at some point a more defensive structuring for a balanced portfolio is called for, having bonds as a reasonable alternative for an investor looking to take some risk out is a welcome development.

2024 OUTLOOK HIGHLIGHTS: BONDS ARE BACK

## United States

### Nimble positioning in equities; bonds could post strong returns

U.S. equities face an unusually high number of crosscurrents in 2024.

There is a wide range of potential economic outcomes possible, as described above.

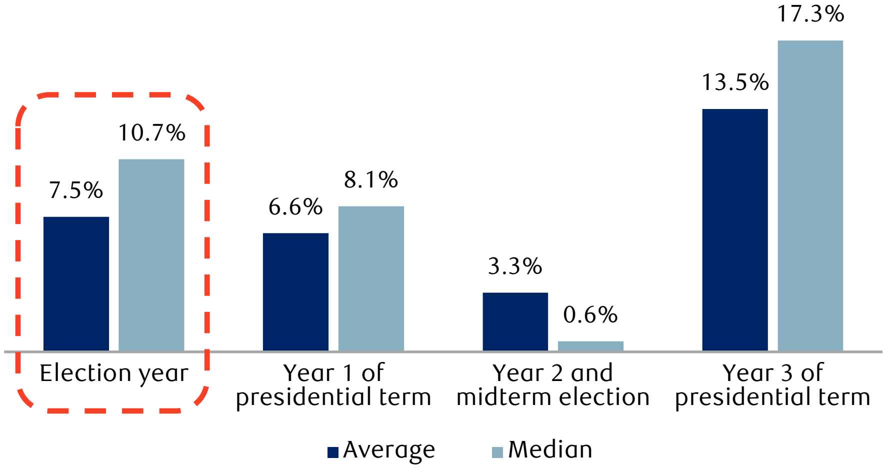
The market seems positioned for a rosy scenario. Industry analysts' S&P 500 consensus earnings forecast of $244 per share in 2024 represents 11.1 percent year-over-year growth. This forecast, combined with the market's 19.3x above-average price-to-earnings ratio, leaves little wiggle room for economic disappointments.

The U.S. presidential election will inevitably generate noise. Investors should remember that since 1928, the S&P 500 rose 7.5 percent on average during presidential election years and ended the year in positive territory almost 75 percent of the time. We believe Fed policy and the economic cycle play greater roles in shaping market returns than political party control in Washington.

Overall, we think S&P 500 returns for the next 12–18 months will largely depend on whether a U.S. recession materializes. But even if one does and the stock market corrects, the market typically establishes a new uptrend partway through the recession period.

The U.S. stock market has historically traded in a four-year pattern associated with elections

S&P 500 performance during presidential election cycles since 1928



Source - RBC Wealth Management, Bloomberg; based on annual data through 2022

To start the year, we recommend maintaining U.S. equities at the Market Weight level to take advantage of the distinct possibility of the S&P 500 reaching new all-time highs in the coming few months. This allocation is also intended to balance the risk of a recession against the possibility that one may be averted.

We anticipate market performance will broaden out beyond the "Magnificent 7" technology-oriented stocks that led by a wide margin for much of 2023.

2024 OUTLOOK HIGHLIGHTS: BONDS ARE BACK

Investors should consider limiting individual stock selections to companies they would be content to own through a recession—those with strong management teams, robust cash flow generation, and healthy balance sheets. We would tilt portfolio holdings toward reasonably valued stocks of high-quality companies. The valuations of small-capitalization stocks in particular seem to already price in a recession.

As for fixed income, we expect a strong bounce-back year to play out over the course of 2024. When bond yields are high, the income earned is often enough to offset most price fluctuations. In fact, for the 10-year Treasury to deliver a negative return in 2024, the yield would have to rise to 5.3 percent. This is relatively unlikely, in our view, as we expect the Fed to embark on a series of modest rate cuts beginning this summer as the economy loses steam.

The bond market's repricing of rate cut expectations will likely be most dramatic at the short end of yield curves. Thus, investors should proactively rotate out of cash and/or cash equivalent products and into longer-dated securities, in order to lock in yields for longer—and before they fade away, in our opinion.

## Canada

### Interest rate risks becoming more two-sided

Restrictive monetary policy continues to work its way through the Canadian economy, weakening it. Meanwhile, inflation risks seem to be easing and additional rate hikes from the Bank of Canada (BoC) are likely on hold, in our view.

For equities, the trajectory of interest rates and the ultimate impact on the consumer will have clear implications for the Canadian banks, in our view. Bank valuations reflect the uncertain environment, and the group trades close to trough levels.

We expect Energy sector stock performance to be largely influenced by commodity prices and note the Canadian energy companies' fortified balance sheets and reasonable capital expenditure needs.

As for fixed income, historically, adding duration following the last BoC rate hike has led to higher total returns relative to short-duration strategies. We suggest extending maturities through laddering, exposing portfolios to a higher degree of rate sensitivity while minimizing return volatility, which should lead to a smoother path of returns.

## United Kingdom

### Opportunities despite the subdued economy

Economic data is likely to slip further as the full impact of much higher interest rates increasingly filters through the economy. We think the Bank of England will likely keep the Bank Rate elevated for much of 2024 as core inflation remains sticky and above five percent. We see a risk of stagflation in the UK.

Despite these challenging prospects, we continue to recommend a Market Weight position in UK equities. Their defensive qualities and attractive valuations should be assets given the more volatile backdrop we are expecting in 2024. The Energy sector currently enjoys a favourable risk-reward profile, in our view.

For fixed income, we would add further to Gilts and increase duration. Credit spreads could widen as credit fundamentals worsen. There are pockets of opportunities in non-cyclical issuers and in senior-ranking bank bonds.

## Europe

### Remain cautious but on the lookout for the next economic upturn

Europe will also likely grapple with anemic economic growth in 2024. The pandemic and the war in Ukraine have compounded the bloc's long-standing structural issues, such as a lack of competitiveness, which conspire to undermine the effectiveness of the EU single market. European Commission task force recommendations to remedy the situation are due in March 2024.

We continue to recommend an Underweight position in European equities as weakening macro and earnings momentum remain headwinds for the region's ability to outperform. However, we are watchful for any green shoots and signs that the euro area's relative economic growth momentum may be improving. This would be a key catalyst to increase allocations given inexpensive valuations.

In fixed income, we would add to sovereign bond positions and duration as the economic outlook looks set to deteriorate further, thus benefiting longer-duration and sovereign positions.

## Asia Pacific

### Overweight Japan equities; prefer Asian investment-grade credit

We suggest an Overweight stance in Japanese equities, where the outlook appears bright thanks to the launch of a revamped tax-exempt investment scheme for residents, corporate pension reforms, onshoring trends, and efforts at improving corporate governance. Relative economic and political stability combines with low valuations to further enhance this market's attractiveness.

Given that China's economic recovery and investor sentiment remain fragile, Chinese equities may continue to trade within a limited range. We would focus on opportunities in industries where China has competitive advantages or which can benefit from policy tailwinds, such as advanced manufacturing and health care.

In Asian fixed income, we continue to prefer investment-grade credit for 2024. The lower U.S. Treasury yields that we expect into 2024 should provide an overall tailwind for Asian credit. We prefer to keep duration short for Asian investment-grade credit due to spread valuations. We like the attractive coupon carry for this resilient segment, but also seek to limit the potential performance impact should valuations reverse.

*For more details on these views, as well as forecasts for commodities and currencies, please have a look at our complete Global Insight 2024 Outlook or the individual articles: Investing for a new reality (feature article), as well as regional focus commentaries on the U.S., Canada, the UK, Europe, and Asia.*

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## Equity

**Jim Allworth**
Vancouver, Canada
jim.allworth@rbc.com

# More to come

The hard versus soft landing debate about the expected path of the U.S. economy is still going strong. We don't think it will be settled definitively until we get an official recession "start date" decision from the National Bureau of Economic Research. However, this typically comes about a year after the fact which makes it largely unhelpful from an investor's tactical standpoint.

For our part, we are persuaded that the combination of high rates and restrictive bank landing standards in place today makes a U.S. recession the most probable outcome. It is important to note that the Federal Reserve had already been cutting funds rates immediately before the start of nine of the past 10 recessions since the 1950s, so the arrival of the first Fed cut should definitely not be interpreted by itself as "Recession Avoided."

Meanwhile, the presence of similar conditions, i.e., high interest rates and restrictive lending, is already taking a toll in Canada, the UK, and the eurozone. GDP growth in all three was no more than a shadow of U.S. growth over the first nine months of 2023.

Of course, one can never rule out the possibility this time will be different. The extreme supportive monetary and fiscal policies introduced in response to the pandemic could conceivably linger long enough to keep the all-important household spending (70% of U.S. GDP) from outright retrenchment. Instead of a multi-quarter decline in GDP, the U.S. economy may do no worse than slow down this year.

That could be enough to keep S&P 500 earnings growing, although probably not by as much as the current consensus estimate for 2024 ($244 per share, up approximately 11% from 2023's expected $220) would suggest. (RBC Capital Markets' estimate sits at $234, up a more modest 6.4%.) We think any earnings growth would leave room for share prices to advance between now and the end of 2024, even if the path for getting there remains in debate.

### Equity views

| Region | Current |
|---|---|
| Global | = |
| United States | = |
| Canada | = |
| Continental Europe | – |
| United Kingdom | = |
| Asia (ex Japan) | = |
| Japan | + |

+ Overweight; = Market Weight; – Underweight
Source - RBC Wealth Management

For now, we recommend remaining sufficiently committed to stocks to take advantage of the distinct possibility of the S&P 500 and other major indexes reaching a new all-time high ground in the coming few months. However, we would consider limiting individual stock selections to companies an investor would be content to own through a recession, which, in our view, is the most probable economic outcome in the coming quarters. For us, that means high-quality businesses with resilient balance sheets, sustainable dividends, and business models that are not intensely sensitive to the economic cycle.

Perhaps the most compelling reason for focusing on resilient, high-quality businesses is that the economic and market valuation headwinds gathering will, in our view, run their course and probably fully dissipate later in 2024 or early 2025. Equity markets typically have anticipated the start of a new economic expansion several months before it gets underway. In our opinion, portfolios that have held their value to a better-than-average degree will be best equipped to take advantage of the opportunities that are bound to present themselves when a stronger pace of economic growth reasserts itself.

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# Fixed income

**Thomas Garretson, CFA**
Minneapolis, United States
tom.garretson@rbc.com

## The subtraction of all fears

As they say, the only constant is change. And oh, how things have changed.

The fourth quarter marked a stark reversal of 2023's major trend of higher yields around the globe. Benchmark 10-year sovereign yields in most developed economies have completely, or notably, wiped out the increases of last year.

At the heart of the move has been a quickly changing inflationary backdrop as disinflationary forces have gathered steam across many regions. In the UK, consumer price inflation fell to a year-over-year pace of 3.9% for November, well below the previous reading of 4.6% and down from the 2022 high of 11.1%. The story was similar in the U.S. where the Federal Reserve's preferred measure of inflation, Personal Consumption Expenditures, showed that prices fell by 0.1% in November, the first monthly decline since April 2020, bringing the annual inflation rate down to just 2.6%. Over the past six months, inflation has been running at 2.0%, in line with the Fed's target.

That progress, combined with other factors, has not only caused markets to finally price the end of rate hike cycles but to also price out the "higher for longer" scenarios that many central banks have clung to, with the first rate cuts now seen in the first half of this year.

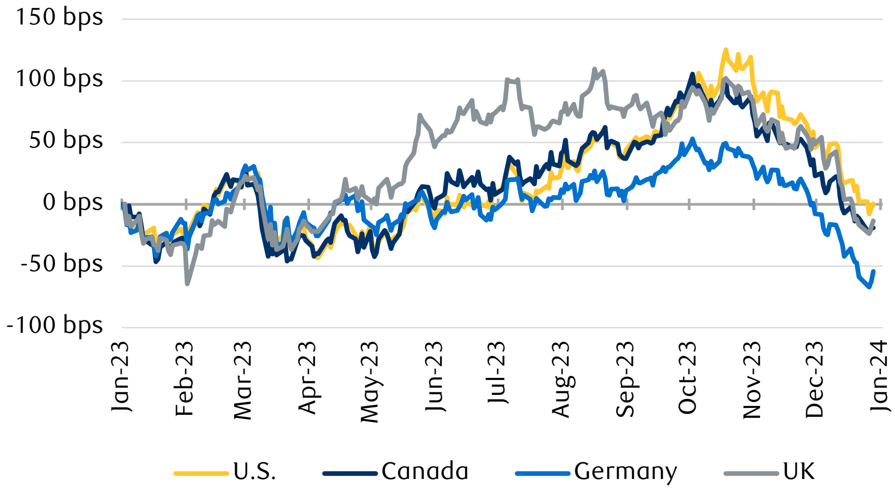
### Fixed income views

| Region | Gov't bonds | Corp. credit | Duration |
|---|---|---|---|
| United States | + | – | 3–7 |
| Canada | = | + | 3–7 |
| Continental Europe | = | = | 3–7 |
| United Kingdom | = | = | 3–7 |

+ Overweight; = Market Weight; – Underweight
Source - RBC Wealth Management

In the U.S., it has not just been the fear of inflation that has dissipated. Over the summer, fears around U.S. sovereign credit rating downgrades and rising levels of Treasury bond issuance to finance deficits in excess of market expectations also helped to push Treasury yields to multi-decade highs. But now those fears appear to be little more than a distant memory. The net result is that the 10-year Treasury yield—which largely feeds into mortgage and other consumer

### 2023: Net change in benchmark 10-year sovereign bond yields



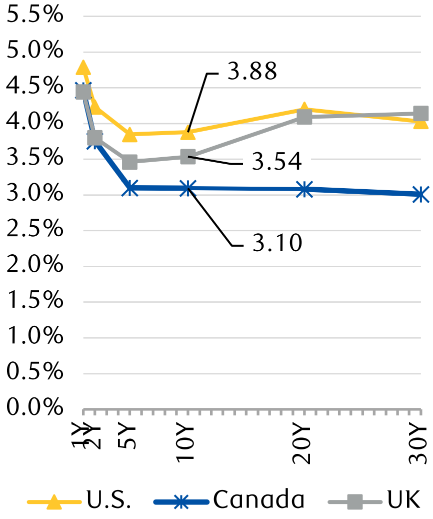
Source - RBC Wealth Management, Bloomberg; shows the net change year to date in respective 10-year sovereign yields; data through 12/29/23

## GLOBAL FIXED INCOME

loan rates—dropped from a peak of 5.0% in October, to as low as 3.8% in December. While policymakers at the Fed projected the potential for three 25 basis point rate cuts in 2024, which would mean a target range of 4.50%–4.75% by year-end, markets are pricing in closer to seven rate cuts to a target range of 3.50%–3.75%, with the first cut possible as early as the March policy meeting.

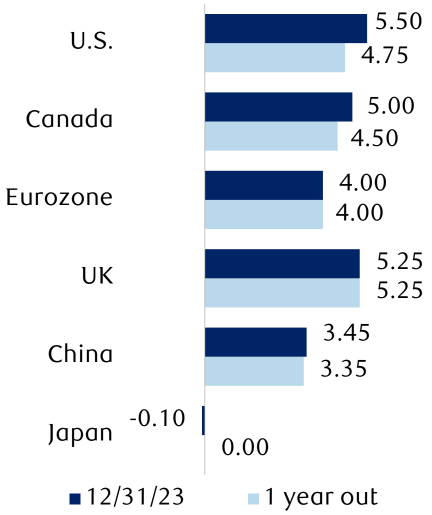
While we previously envisioned a lower rate environment in 2024, markets—forward looking as they are—may have already priced much of our expected decline. Fixed income markets will likely remain volatile early in the year, in our view, as traders gauge the timing, extent, and—more importantly—the reasons for central bank rate cuts. However, we believe that rates have peaked and will continue to fade this year, and that any rise in yields would only be cause to put money to work, in our view.

### Sovereign yield curves



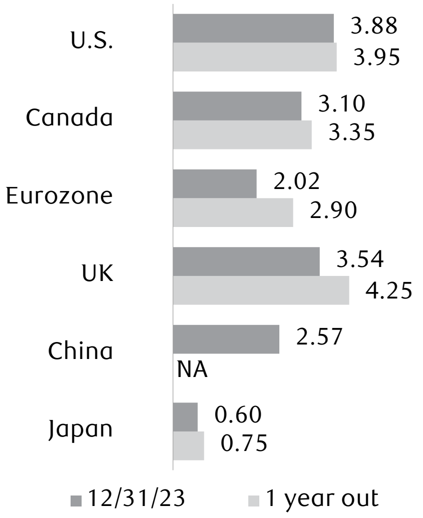
Source - Bloomberg; data through 12/31/23

### Central bank rates (%)



Source - RBC Investment Strategy Committee, RBC Capital Markets forecasts, Global Portfolio Advisory Committee, RBC Global Asset Management

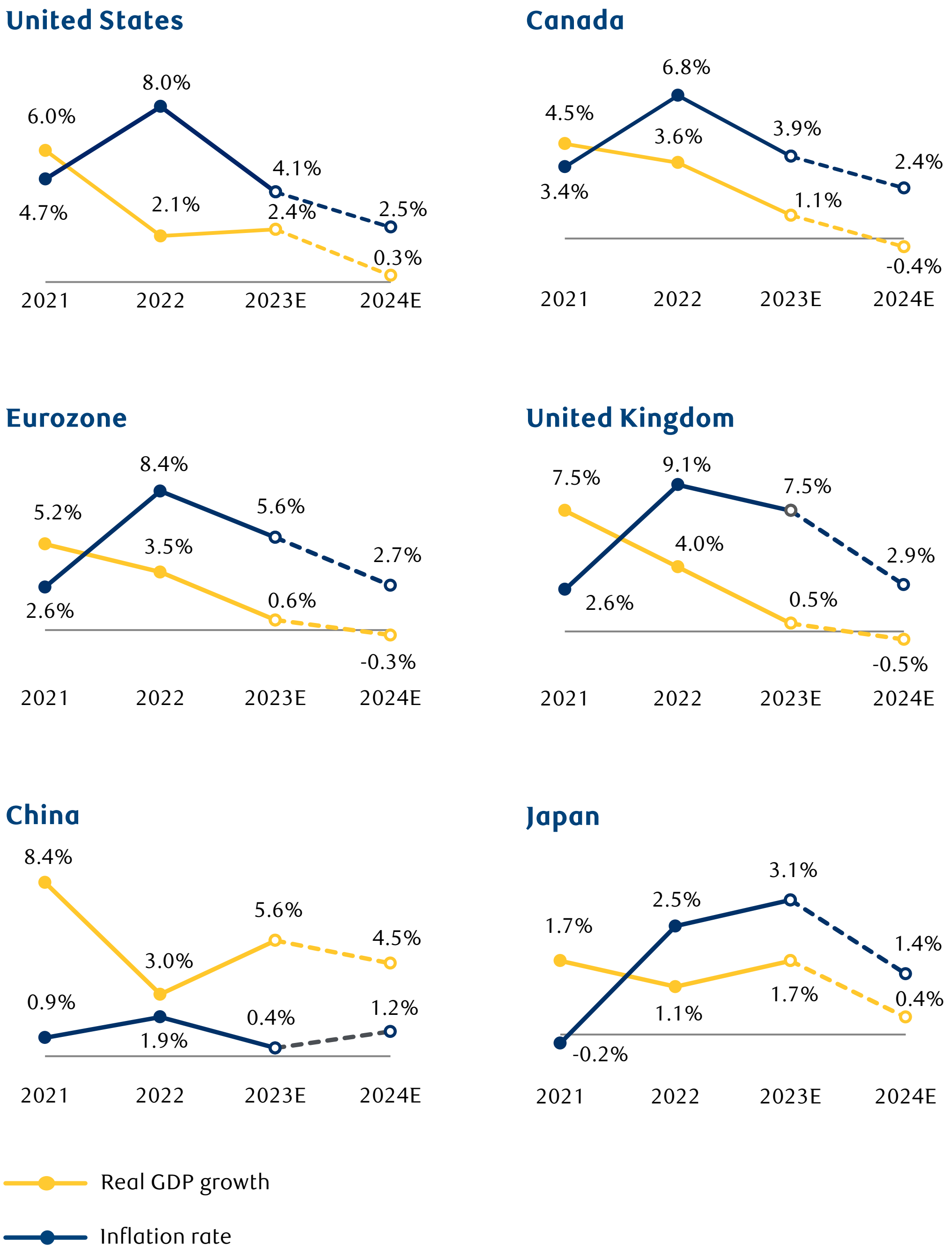
### 10-year rates (%)



Note: Eurozone utilizes German Bunds.
Source - RBC Investment Strategy Committee, Global Portfolio Advisory Committee, RBC Global Asset Management

KEY

# Forecasts



Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management, Bloomberg consensus estimates

# Market scorecard

Data as of December 31, 2023

## Equities

The majority of global equity markets posted gains in December with the exception of the Shanghai Composite and Nikkei 225, which came under selling pressure.

## Bond yields

Sovereign bond yields fell across the globe in December amid improving economic indicators and the possibility of rate cuts in 2024. Government bond yields in the UK fell the most, followed by Treasury bonds.

## Commodities

Global commodity prices declined in December with the exception of gold and copper.

## Currencies

The U.S. dollar, down 2.1%, weakened against a majority of the world's major currencies.

| Index (local currency) | Level | 1 month | YTD | 12 month |
|---|---|---|---|---|
| S&P 500 | 4,769.83 | 4.4% | 24.2% | 24.2% |
| Dow Industrials (DJIA) | 37,689.54 | 4.8% | 13.7% | 13.7% |
| Nasdaq | 15,011.35 | 5.5% | 43.4% | 43.4% |
| Russell 2000 | 2,027.07 | 12.1% | 15.1% | 15.1% |
| S&P/TSX Comp | 20,958.44 | 3.6% | 8.1% | 8.1% |
| FTSE All-Share | 4,232.01 | 4.4% | 3.8% | 3.8% |
| STOXX Europe 600 | 479.02 | 3.8% | 12.7% | 12.7% |
| EURO STOXX 50 | 4,521.65 | 3.2% | 19.2% | 19.2% |
| Hang Seng | 17,047.39 | 0.0% | -13.8% | -13.8% |
| Shanghai Comp | 2,974.94 | -1.8% | -3.7% | -3.7% |
| Nikkei 225 | 33,464.17 | -0.1% | 28.2% | 28.2% |
| India Sensex | 72,240.26 | 7.8% | 18.7% | 18.7% |
| Singapore Straits Times | 3,240.27 | 5.4% | -0.3% | -0.3% |
| Brazil Ibovespa | 134,185.24 | 5.4% | 22.3% | 22.3% |
| Mexican Bolsa IPC | 57,386.25 | 6.2% | 18.4% | 18.4% |
| **Bond yields** | **12/31/23** | **11/30/23** | **12/31/22** | **12 mo. chg** |
| U.S. 2-Yr Tsy | 4.250% | 4.680% | 4.426% | -0.18% |
| U.S. 10-Yr Tsy | 3.879% | 4.326% | 3.875% | 0.00% |
| Canada 2-Yr | 3.890% | 4.194% | 4.054% | -0.16% |
| Canada 10-Yr | 3.110% | 3.554% | 3.300% | -0.19% |
| UK 2-Yr | 3.984% | 4.608% | 3.576% | 0.41% |
| UK 10-Yr | 3.537% | 4.176% | 3.672% | -0.14% |
| Germany 2-Yr | 2.404% | 2.816% | 2.764% | -0.36% |
| Germany 10-Yr | 2.024% | 2.447% | 2.571% | -0.55% |
| **Commodities (USD)** | **Price** | **1 month** | **YTD** | **12 month** |
| Gold (spot $/oz) | 2,062.98 | 1.3% | 13.1% | 13.1% |
| Silver (spot $/oz) | 23.80 | -5.8% | -0.7% | -0.7% |
| Copper ($/metric ton) | 8,463.92 | 0.9% | 1.2% | 1.2% |
| Oil (WTI spot/bbl) | 71.65 | -5.7% | -10.7% | -10.7% |
| Oil (Brent spot/bbl) | 77.04 | -7.0% | -10.3% | -10.3% |
| Natural Gas ($/mmBtu) | 2.51 | -10.3% | -43.8% | -43.8% |
| Agriculture Index | 386.81 | -3.4% | -17.8% | -17.8% |
| **Currencies** | **Rate** | **1 month** | **YTD** | **12 month** |
| U.S. Dollar Index | 101.3330 | -2.1% | -2.1% | -2.1% |
| CAD/USD | 0.7551 | 2.4% | 2.3% | 2.3% |
| USD/CAD | 1.3243 | -2.3% | -2.3% | -2.3% |
| EUR/USD | 1.1039 | 1.4% | 3.1% | 3.1% |
| GBP/USD | 1.2731 | 0.8% | 5.4% | 5.4% |
| AUD/USD | 0.6812 | 3.1% | 0.0% | 0.0% |
| USD/JPY | 141.0400 | -4.8% | 7.6% | 7.6% |
| EUR/JPY | 155.7200 | -3.5% | 10.9% | 10.9% |
| EUR/GBP | 0.8669 | 0.5% | -2.1% | -2.1% |
| EUR/CHF | 0.9289 | -2.5% | -6.1% | -6.1% |
| USD/SGD | 1.3203 | -1.3% | -1.4% | -1.4% |
| USD/CNY | 7.1000 | -0.5% | 2.9% | 2.9% |
| USD/MXN | 16.9720 | -2.4% | -13.0% | -13.0% |
| USD/BRL | 4.8572 | -1.3% | -8.0% | -8.0% |

Equity returns do not include dividends, except for the Brazilian Ibovespa. Equity performance and bond yields in local currencies. U.S. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

Examples of how to interpret currency data: CAD/USD 0.75 means 1 Canadian dollar will buy 0.75 U.S. dollar. CAD/USD 2.3% return means the Canadian dollar has risen 2.3% vs. the U.S. dollar during the past 12 months. USD/JPY 141.04 means 1 U.S. dollar will buy 141.04 yen. USD/JPY 7.6% return means the U.S. dollar has risen 7.6% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 12/31/23

# Research resources

This document is produced by the Global Portfolio Advisory Committee within 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.

The Global Portfolio Advisory Committee leverages the broad market outlook as developed by the RBC Investment Strategy Committee (RISC), providing additional tactical and thematic support utilizing research from the RISC, RBC Capital Markets, and third-party resources.

The RISC consists of senior investment professionals drawn from individual, client-focused business units within RBC, including the Portfolio Advisory Group. The RISC builds a broad global investment outlook and develops specific guidelines that can be used to manage portfolios. The RISC is chaired by Daniel Chornous, CFA, Chief Investment Officer of RBC Global Asset Management Inc.

## Global Portfolio Advisory Committee members

**Jim Allworth –** Co-chair
Investment Strategist, RBC Dominion Securities Inc.

**Kelly Bogdanova –** Co-chair
Portfolio Analyst, RBC Wealth Management Portfolio Advisory Group U.S., RBC Capital Markets, LLC

**Frédérique Carrier –** Co-chair
Managing Director & Head of Investment Strategy, RBC Europe Limited

**Mark Bayko, CFA –** Head, Portfolio Management, RBC Dominion Securities Inc.

**Rufaro Chiriseri, CFA** – Head of Fixed Income – British Isles, RBC Europe Limited

**Janet Engels –** Head, Portfolio Advisory Group U.S., RBC Wealth Management, RBC Capital Markets, LLC

**Thomas Garretson, CFA –** Fixed Income Senior Portfolio Strategist, RBC Wealth Management Portfolio Advisory Group, RBC Capital Markets, LLC

**Patrick McAllister, CFA –** Manager, Equity Advisory & Portfolio Management, Portfolio Advisory Group, RBC Dominion Securities Inc.

**Alan Robinson –** Senior Portfolio Advisor, RBC Wealth Management Portfolio Advisory Group – U.S. Equities, RBC Capital Markets, LLC

**Michael Schuette, CFA –** Multi-Asset Portfolio Strategist, RBC Wealth Management Portfolio Advisory Group – U.S., RBC Capital Markets, LLC

**David Storm, CFA, CAIA** – Chief Investment Officer, BI & Asia, RBC Europe Limited

**Yuh Harn Tan** – Head of Discretionary Portfolio Management & UHNW Solutions, Royal Bank of Canada, Singapore Branch

**Joseph Wu, CFA** – Portfolio Manager, Multi-Asset Strategy, RBC Dominion Securities Inc.

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As of December 31, 2023

| | | | Investment Banking Services Provided During Past 12 Months | |
|---|---|---|---|---|
| Rating | Count | Percent | Count | Percent |
| Buy [Outperform] | 829 | 57.17 | 253 | 30.52 |
| Hold [Sector Perform] | 575 | 39.66 | 154 | 26.78 |
| Sell [Underperform] | 46 | 3.17 | 6 | 13.04 |

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