RBC Global Asset Management

QUARTERLY REVIEW & OUTLOOK

September 30, 2011

The global economy and financial markets are suffering from a crippling crisis of confidence. U.S. lawmakers shocked investors everywhere as the summer's budget debate gridlocked. We have seen the alarming spread of Europe's debt crisis from its periphery to its center. What looked like decent growth in the first half of the year turned out to be a mirage, and momentum since then has been weak across the developed world. The recovery that was widely expected to take root over the second half of 2011 simply hasn't developed.

Excerpted from the RBC Investment Strategy Committee's Global Investment Outlook - Summer 2011 edition

In the absence of an obvious catalyst to turn around this gloomy mood, the economic outlook looks considerably grimmer. At worst, the developed world could enter a second phase of the financial crisis. More likely, an extended period of sluggish growth appears to be at hand. Risk aversion may remain somewhat elevated, bond yields may be lower for longer and stock markets will remain uncertain due to the likelihood of slower corporate profit growth and prospects for lower earnings multiples.

Muddle-Through Economic Scenario Still Our Base Case

Talk of disappointing data and slower economic growth naturally leads to the sport of recession-handicapping. Our base case remains a muddle-through economic scenario that avoids outright contraction. We peg the probability of a U.S. recession at between 25% and 50% over the next year, and somewhat higher for the Eurozone. Despite the generally disappointing orientation, current economic data is not yet consistent with a recession, and even if one does develop, it seems unlikely that it will be particularly deep. All told, the economic recovery will likely be bumpy, slow and long.

We have revised our global economic outlook lower. This applies primarily to the U.S., but it is clear that many economies have also lost a step. We believe the extent of our economic downgrades are sufficient to reflect the new reality, but there is no denying a powerful undertow that could yet force further revisions.

However, a balanced assessment is important. Whereas our previous economic forecasts were modestly below consensus due to our anticipation of some of these emergent problems, our new (lower) forecasts are now broadly in line with the market's revised thinking.

In Europe, Greece, Ireland and Portugal are still fighting for their survival with the assistance of an alphabet soup of institutions and bailouts. Given looming parliamentary battles over the latest round of bailouts, and our fear that the program is too small anyway, it remains the odds-on bet that Greece will be forced into a larger restructuring over the next year or two. Ireland and Portugal are tougher calls. Alarmingly, Italy and Spain have now been sucked into the vortex of fear, increasing their borrowing costs. The risk is that their temporary liquidity challenges could become solvency problems should the cost of borrowing continue to rise. We still believe that Italy and Spain can resolve their internal problems, although diminishing global growth prospects are making that judgment less certain. The bottom line is that event risk remains enormous in Europe, and the European economy should continue to suffer for it.

Dollar Bouncing Near the Bottom

Throughout the summer, the dollar failed to rebound more than 5% from its all-time lows, despite its status as a safe-haven asset and nearly 20% undervaluation on a PPP basis. S&P's downgrade of the U.S. credit rating, combined with the debt-ceiling debate and disappointing economic growth, have prompted investors to instead seek safety in gold, the Swiss franc and even the yen. In addition, the recent commitment of the Fed to hold rates low through 2013 delayed any chance of short-term interest rate support for the dollar. From a longer-term perspective, however, we believe that investors should buy the dollar on weakness against major currencies because, at current levels, it should be able to withstand bad economic news much better than currencies of other major economies. That includes the Canadian dollar, which is particularly sensitive to downgraded expectations of slower global growth (and at levels beyond parity has been priced for perfection).

Inflation Muted and Short Rates Expected to Remain Low
The market has swung between inflation and deflation concerns over the past several years. Certainly, there is plenty of fodder for fear-mongering at both ends of the spectrum. The market is finally learning to discount both extremes, and is concluding that neither is a great concern at present. The Fed remains heroic in its actions, having completed a second round of quantitative easing in June, only to be prodded into still more stimulus in August. It has now committed to leaving its target for the fed funds rate unchanged until mid-2013. Although the Federal Open Market Committee is clearly divided, we believe the odds of still more monetary stimulus are good. The European Central Bank (ECB) is likely finished with its ill-advised tightening campaign and should instead remain on hold for the coming year, with the chance of some modest easing. The Bank of Canada (BOC) is among the least likely of the developed countries to pursue easy policy, and should be among the first to revert to tightening once conditions normalize. We pencil in additional tightening by the BOC for the middle of 2012.

Clear Upside Risks to Bond Yields
Longer-term bond yields have fallen dramatically in recent months to lows not seen since the late 1940s. High and rising perceptions of risk elsewhere in the market are driving investors toward U.S. Treasuries, pushing down their yield as money flows away from other assets. A real yield (i.e., after inflation) of zero, and in turn a sub-2.0% nominal yield, reflects today's extreme levels of risk aversion, not a reasonable view of the long-term prospects for the U.S. and global economy. Economic "normalization," whenever and however it appears, poses a meaningful challenge for investors in Treasuries, and bonds of virtually all developed countries, as real interest rates gradually move back up, dragging nominal yields with them.

Equities Cheap, but Risk Aversion Dominates
We had expected all major equity indexes to exhibit a higher-than-usual degree of volatility during the summer, and we were not disappointed. Despite continued solid earnings gains, equity-market valuations tumbled in mid-summer. Risk aversion soared and the market priced in a greater likelihood of a second recession in three years which, if realized, would mean that the recent history of stronger-than-expected earnings will not be sustained. Although wild swings in equity markets may seem irrational at times, they are not. Investors have recalibrated their outlook to reflect the growing possibility of some really bad outcomes, while at the same time recognizing that stocks offer compelling returns if those outcomes don't appear. ■

Firm Update

New Employees

RBC GAM (US) is pleased to announce the addition of the following employees to our team:

Berit Christoff
Administrative Assistant

Ryan Cole
Portfolio Administrator

Richard Johnson
Client Service Portfolio Manager

Adam Moldavan
Cash Management Operations Specialist

Chad Rice
Vice President, Portfolio Manager

Kari Terrio
Junior Relationship Manager

Jackie Weitzel
Receptionist

RBC GAM (US)

A History of Consistent Growth
Assets Under Management
($ Billions)

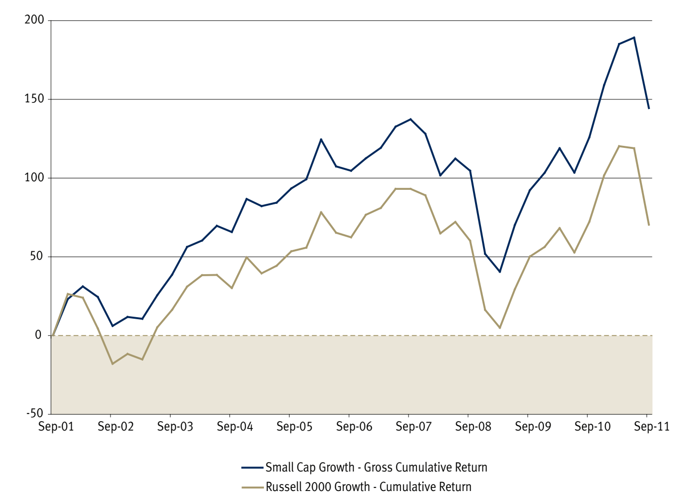
**Preliminary as of 9.30.11*

In the Spotlight

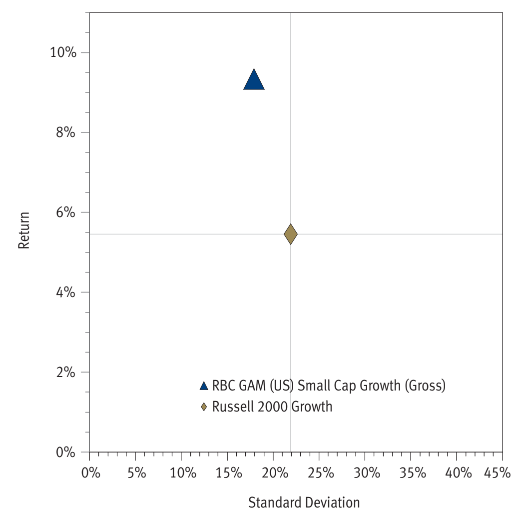
RBC GAM (US) Small Cap Growth Equity

The RBC GAM (US) Small Cap Growth strategy seeks superior capital appreciation through careful selection from a universe of high-quality, small-capitalization growth companies. As a conservative growth investor, the team employs a bottom-up fundamental approach, coupled with a long-term investment horizon to select profitable companies selling at reasonable valuations. This risk-controlled approach has historically enabled clients to reap the benefits of strong markets while providing significant downside protection as evidenced by the strategy's 10-year performance and risk return profile.

Performance[1] (October 2001 - September 2011)



Risk Return Profile[1] (October 2001 - September 2011)



The Small Cap Growth investment management team brings a unique perspective to its investment decisions. Each team member holds CFA and CPA certifications along with public accounting experience, which allows them to develop an understanding of companies that goes well beyond traditional research. That expertise, coupled with the team's long tenure and consistent investment philosophy has enabled the strategy to outperform its benchmark over all pertinent time periods since its inception.

Annualized Returns[1]	QTD	YTD	1 Year	3 Years	5 Years	7 Years	Since Inc.
RBC GAM (US) Small Cap Growth (Gross)	-15.48%	-5.60%	8.19%	6.11%	3.62%	5.72%	9.34%
Russell 2000 Growth Index	-22.25%	-15.57%	-1.12%	2.07%	0.96%	3.93%	5.45%

Source: Zephyr StyleADVISOR

[1] Performance shown preliminary as of 9.30.11. Returns include the reinvestment of all income. All returns for periods greater than one year are shown on an annualized basis. Inception of the performance record is 10.1.01. The RBC GAM (US) Small Cap Growth Equity composite is presented as supplemental to the "Performance Presentation & Disclosures" which contains additional GIPS®-required disclosures and important information regarding calculation of performance data and is available upon request. Past performance is not a guarantee of future results. Performance for the period March 2009 through March 2010 occurred during a period where the equity and fixed income markets rebounded from a significant market downturn. It should not be assumed that clients will experience future returns comparable to those short-term returns for that period.

Gross performance returns do not reflect the deduction of investment advisory fee and/or other account expenses that may be paid to RBC GAM (US). Return is calculated on an equally weighted, total return basis, and includes the reinvestment of all income. The payment of fees and other expenses, compounded over time, will reduce an account's overall performance. For example, a $10 million portfolio earning a 10% annualized return over five years would be valued at $16.4 million. The same portfolio with an annual advisory fee of 0.95% would be valued at $15.6 million after deduction of the advisory fees over the period.

RBC Global Asset Management

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