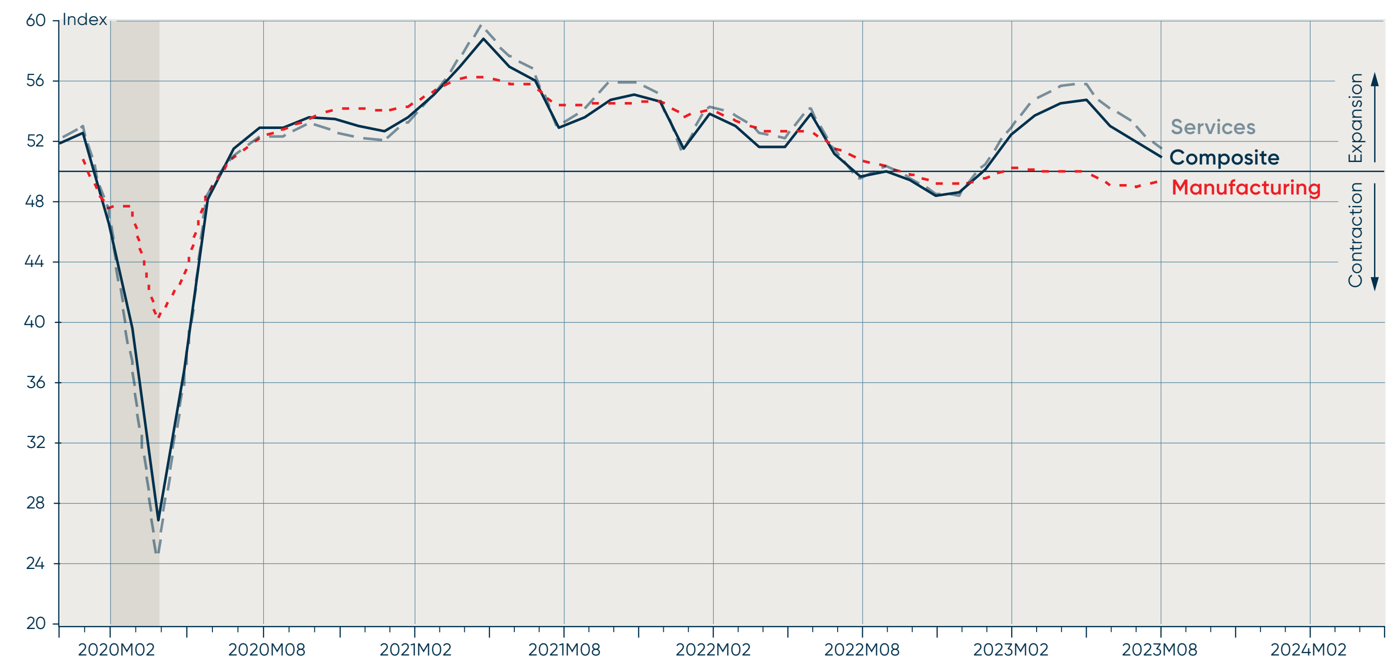
Investment Strategy

World

When China abandoned its "zero COVID" policy at the end of last year, most forecasters expected its economy to follow the post-pandemic path charted by its Western counterparts, characterized by a boom in household spending and a rapid rebound in the property sector. For a while, these projections looked set to become reality. Indeed, Chinese growth surged in the early months of 2023, as demand built up during the lockdowns was finally exercised. The honeymoon did not last long, however, and optimism soon gave way to doubts about the sustainability of the recovery. These doubts proved well-founded when second-quarter GDP data were published, revealing a significant deceleration. Meanwhile, the eurozone recorded respectable growth in the second quarter, but this was due to exceptional events, the effect of which is likely to be cancelled out in Q3 if the August PMI index is anything to go by. China and the eurozone account for 35% of the world's economy. And while weakness in these two regions may initially be masked by solid growth in the United States, it will nonetheless weigh on global growth for the rest of the year. The latter should come in at 3.0% in 2023 before slipping to 2.2% next year.

World: Global economic activity is losing steam
JPMorgan/Markit Global PMI. Last observation: August 2023



NBF Economics and Strategy (data via Refinitiv)

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

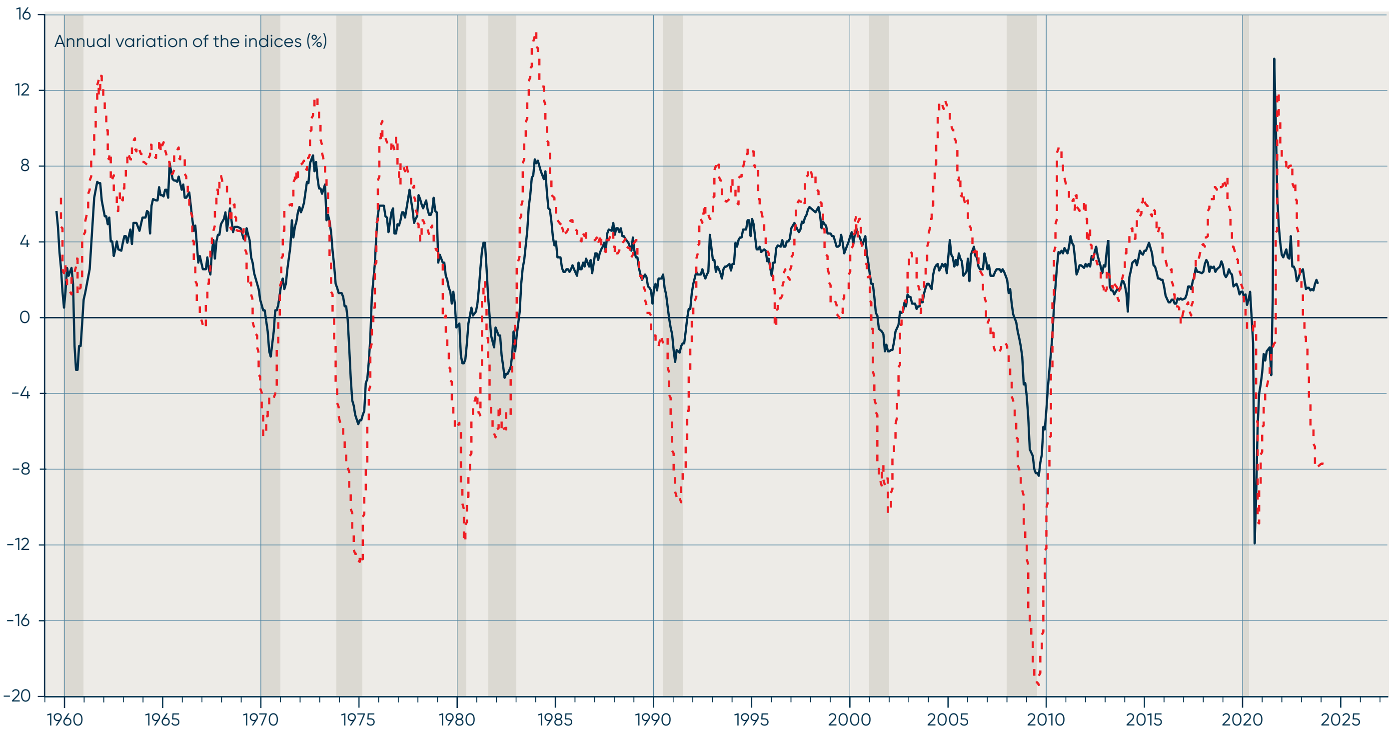
In this issue

United States

Most economists, including ourselves, would surely agree that the U.S. economy is holding up better than expected after the aggressive monetary tightening set in motion by the Federal Reserve last year. It's true that, apart from a wave of bank failures in the spring, the 525 basis point increase in benchmark rates doesn't seem to have done too much harm to growth. Excess savings is one of the causes of this resilience, as is the significant increase in the federal government's deficit. And although it seems ill-advised at a time when inflation is still well above the central bank's target, the U.S. government's lax fiscal policy should nevertheless continue to support the economy in the third quarter. Ditto for a number of other temporary factors, such as Taylor Swift's and Beyoncé's concert tours. And while it's true that some of the money spent on entertainment during the quarter may not be spent elsewhere (substitution effect), household consumption, which accounts for two thirds of the U.S. economy, will nonetheless be positively influenced. Unfortunately, in a context where the rise in household spending was not accompanied by a corollary increase in disposable income, but was rather the result of a significant drop in the savings rate, we fear that the burst of vigour will be very short-lived. After growing at a pace well above potential in Q3, we see the U.S. economy slowing down sharply in Q4, before slipping into technical recession in the early months of 2024. According to this scenario, real GDP should grow by 2.4% in 2023 before stalling in 2024 (+0.0%).

U.S.: The economy is resilient, but for how long?

Annual change in the Conference Board's coincident and leading economic indicators (indices)



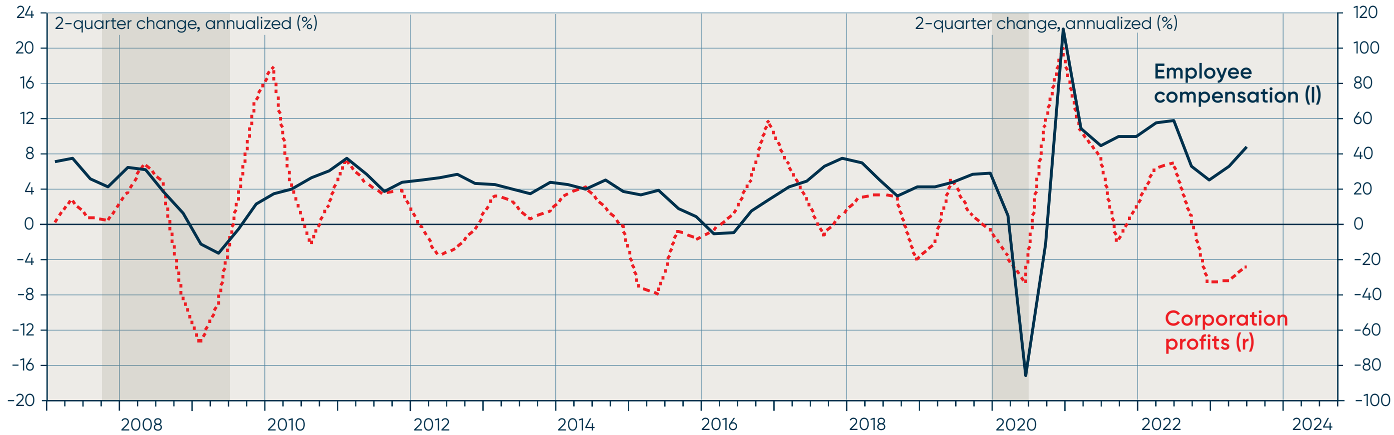
NBF Economics and Strategy (data via Conference Board)

Canada

The Bank of Canada raised its policy rate twice this summer, losing patience with the lack of progress on the inflation front and what it saw as overly strong domestic demand. These decisions are perilous, as the economy was already showing signs of underlying weakness and had yet to feel the full impact of the rate hikes implemented since the start of the tightening cycle. Second-quarter data released in early September showed weaker growth than the central bank had expected, which may have been a factor in its decision to pause in September despite inflation still being too high. Under normal circumstances, a quarter of stagnation in GDP would not necessarily be a cause for concern, but the current demographic explosion changes the picture. Real GDP per capita fell at an annualized rate of 3.3%. Over the last four quarters, it has fallen by 2.0%, which historically has only occurred during recessions. Whenever GDP per capita was below the previous year's level, the central bank was already in easing mode, which contrasts with the BoC's current hawkish stance. What's more, the labour market is easing rapidly, judging by the rise in the unemployment rate in recent months and the perception among SMEs that labour shortages appear to be diminishing. And there is every reason to believe that companies' appetite for hiring will be very weak in the months ahead. The sharp fall in profits since the start of the year is simply incompatible with rising employee compensation, which could lead to difficult decisions for companies. With monetary policy being the tightest in real terms since 2009, and the most restrictive among G7 countries, we continue to anticipate economic lethargy over the next 12 months. We expect growth of 1.0% in 2023 and 0% in 2024.

Canada: A divergence that does not bode well for hiring

Compensation of employees and corporate profits



NBF Economics and Strategy (data via Statistics Canada)

Investment Strategy

After an optimistic start to July, equity markets experienced a slightly more turbulent period over the following two months, ending the quarter with little change. Bonds, for their part, remained under pressure, with Canadian benchmark yields momentarily surpassing their October 2022 levels to set a new high in almost 15 years.

In short, the story of the summer of 2023 was one of U.S. growth continuing to exceed expectations, with consumers showing surprising resilience. At the same time, the economy has been buoyed by substantial fiscal spending, leading to a boom in the construction of manufacturing projects and the repatriation of supply chains to American soil. The big question now is whether this situation is representative of a trend that is gaining momentum or losing steam.

On a forward-looking basis, a number of indicators point to greater fragility over a six-month horizon, with, among other things, the exhaustion of excess household savings and the lagged effects of a year and a half of interest rate hikes yet to be fully felt. What's more, the labour market is beginning to show signs of cooling, with the recent decline in job openings having gathered pace. Added to this is the U.S. debt ceiling deal, which suggests that government spending will not be able to continue to support economic growth as much over the coming quarters.

However, the decisive factor for the markets is likely to be the evolution of the monetary policy stance of major central banks. For the time being, while a rapid fall in inflation would be the best scenario for stocks, and would allow for possible rate cuts, this scenario seems unlikely to us. Indeed, a certain stagnation—or even an increase—in inflation seems more likely for the rest of the year, which could force policymakers to at least keep the door open to further interest rate hikes.

Under these circumstances, we took advantage of investors' optimism at the start of the quarter to further reduce our tactical equity allocation, this time mainly in favour of U.S. Treasury bonds, in order to ensure some exposure to the U.S. dollar, whose defensive properties are well proven. As a result, our positioning shows an underweight in equities against an equal overweight between bonds and cash. Geographically, we continue to underweight emerging markets, for which the strength of the U.S. dollar and the increasingly apparent weakness of the Chinese economy are major headwinds. On the other hand, the Canadian stock market still seems to us a good candidate for outperformance, benefiting from already compressed valuations.

MODEL PORTFOLIOS

Income Portfolio

Investor Profile: You want to preserve your capital or establish a source of periodic income to finance ongoing expenses. You do not find the stock market very attractive because of its volatility, but you are not against the idea of investing a small part of your portfolio in stocks, mainly to counteract the effects of inflation. Your tolerance for risk is low.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	5.0%	8.75%	0.5%
Fixed income (duration: 7.25 years)[1]	60% to 100%	70.0%	71.00%	0.5%
Canadian equities	0% to 30%	8.0%	7.00%	-0.5%
U.S. equities		8.0%	6.25%	-0.25%
Foreign equities		4.0%	2.00%	-0.25%
Alternative investments[2]	0% to 20%	5.0%	5.0%	0.0%

Conservative Portfolio

Investor Profile: On the whole, you want your portfolio invested in fixed-income securities. Although you can tolerate limited volatility to ensure that your assets will grow, you prefer having a portfolio consisting mainly of fixed-income investments for reasons of stability. Your tolerance for risk is low.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	5.0%	10,0%	0.5%
Fixed income (duration: 7.25 years)[1]	45% to 80%	55.0%	58.0%	1.0%
Canadian equities	20% to 45%	14.0%	12.5%	-0.5%
U.S. equities		14.0%	11.0%	-0.5%
Foreign equities		7.0%	3,5%	-0.5%
Alternative investments[2]	0% to 20%	5.0%	5.0%	0.0%

Balanced Portfolio

Investor Profile: You give equal importance to achieving growth in your investments and receiving income. You can tolerate moderate changes in market value to ensure growth, but you prefer having a mix of fixed-income investments and equities for reasons of stability.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	5.0%	9.5%	0.0%
Fixed income (duration: 7.25 years)[1]	30% to 65%	40.0%	44.0%	1.0%
Canadian equities	30% to 65%	18.0%	16.5%	-0.5%
U.S. equities		18.0%	15.0%	-0.5%
Foreign equities		9.0%	5.0%	0.0%
Alternative investments[2]	0% to 25%	10.0%	10.0%	0.0%

Growth Portfolio

Investor Profile: Your main goal is capital growth. Although you can tolerate greater volatility in order to increase the value of your assets, you are not prepared to invest your entire portfolio in stocks. Your tolerance for risk is high.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 25%	5.0%	9.5%	0.5%
Fixed income (duration: 7.25 years)[1]	20% to 45%	30.0%	34.0%	1.0%
Canadian equities	40% to 75%	22.0%	20.5%	-0.5%
U.S. equities		22.0%	19.0%	-0.5%
Foreign equities		11.0%	7.0%	-0.5%
Alternative investments[2]	0% to 25%	10.0%	10.0%	0.0%

Maximum Growth Portfolio

Investor Profile: You want to maximize the eventual return on your capital by investing all or most of your portfolio in the stock market. In doing so, you accept higher volatility of your investment returns in the hope that these returns will ultimately be higher. Your tolerance for risk is high.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 30%	5.0%	9.5%	0.0%
Fixed income (duration: 7.25 years)[1]	0% to 30%	15.0%	20.5%	1.0%
Canadian equities	55% to 100%	26.0%	24.0%	-0.5%
U.S. equities		26.0%	23.0%	0.0%
Foreign equities		13.0%	8.0%	-0.5%
Alternative investments[2]	0% to 30%	15.0%	15.0%	0.0%

1 FTSE TMX Canada Universe Index
2 Includes hedge funds, global infrastructure and gold

FORECAST

	2021	2022	2023 (Forecast)	2024 (Forecast)
Gross Domestic Product %				
Canada	5.0	3.4	1.0	0.0
U.S.	5.9	2.1	2.4	0.0
Inflation %				
Canada	3.4	6.8	3.8	2.4
U.S.	4.7	8.0	4.0	2.3

	September 2023		December 2023		December 2024	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-bills, 91-day)	5.05	5.45	4.95	5.35	3.90	4.50
10-year bond yields	3.65	4.20	3.45	4.05	3.10	3.70
30-year bond yields	3.45	4.30	3.30	4.20	3.10	3.80
Canadian Dollar	US $0.74		US $0.72		US $0.75	

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