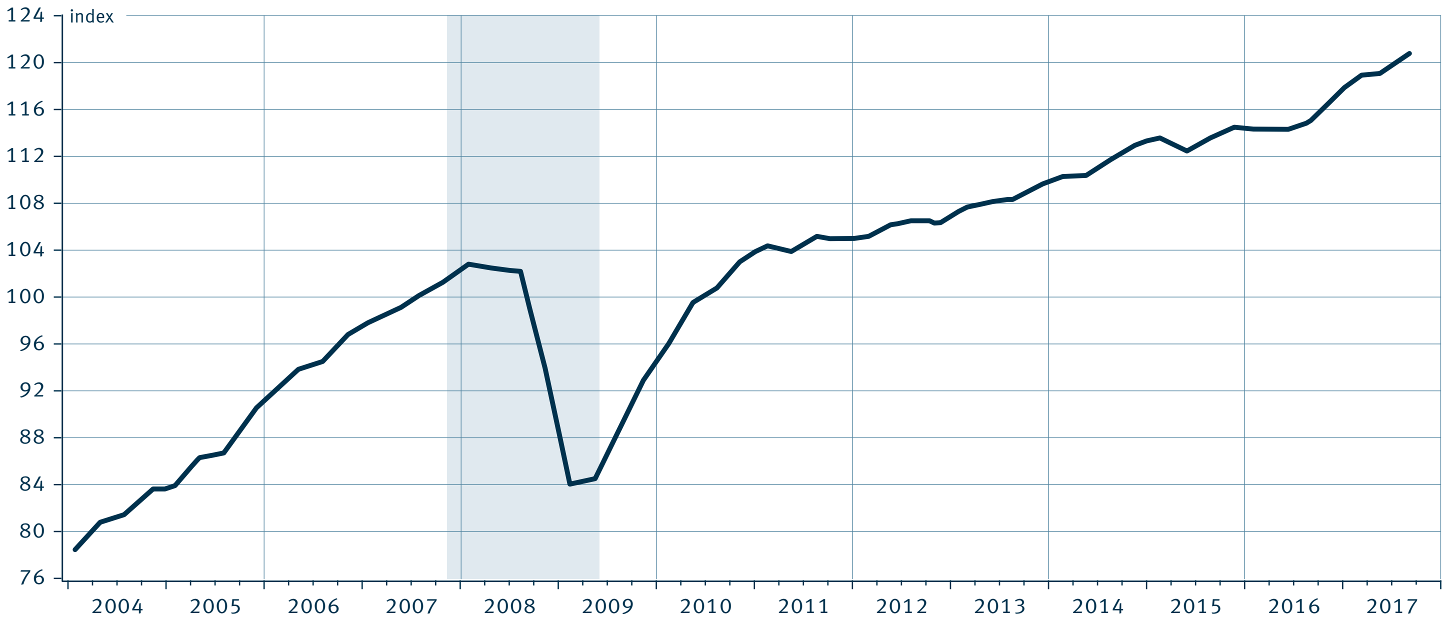
Investment Strategy

World

Despite the most challenging geopolitical backdrop in two decades, world GDP growth for 2017 is on track to be the best in six years, thanks to an OECD rebound which complemented continued strength in emerging markets. Part of the strong economic performance is due to the extension of highly stimulating government policies, but buoyant global trade volumes have also helped. The latter explains why factories are booming in several of the world's major economies. Slightly higher inflation could have some central banks tighten policy somewhat in 2018, although that's unlikely to be enough to prevent a repeat of this year's solid growth performance.

World: Trade volumes at a record

Global trade flows (quarterly volumes)



NBF Economics and Strategy (CPB data via Datastream)

In this issue

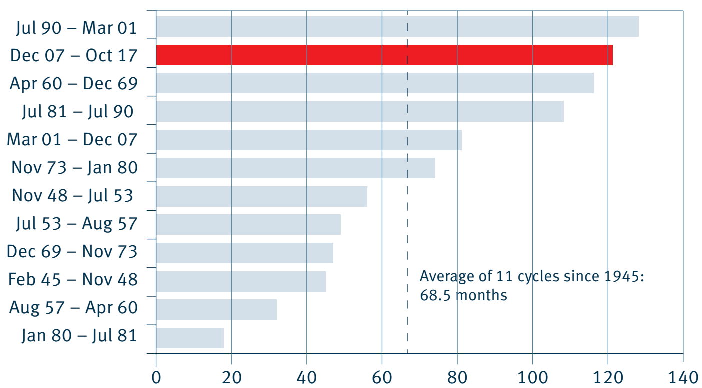
NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

United States

As the U.S. economy enters its 121st month since the pre-recession peak and the S&P 500 reaches new highs, leading indicators are still flashing green. Business investment has sprung back to life, thanks to the stabilization of the energy sector and improved confidence amidst a buoyant global economy. Full-time employment is also up 2.4 million so far in 2017, the best performance since 2006. With the American economy on a clear uptrend – real GDP growth is expected near 2.2% for 2017 and to improve further in 2018 – the Federal Reserve is set to tighten monetary policy further, as another year of above-potential growth can be expected, thanks in part to tax cuts.

U.S.: The second longest business cycle on record

Duration of economic cycles since 1945 (peak to peak)



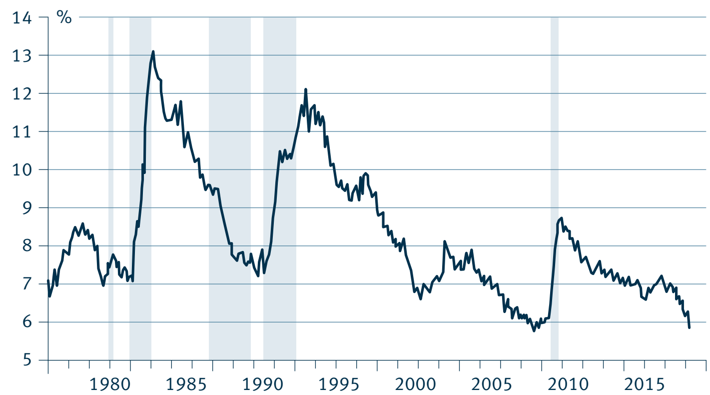
NBF Economics and Strategy (http://www.nber.org/cycles.html)

Canada

Newly revised GDP data suggest the Canadian economy is in better shape than previously thought. A blistering first half was followed by a decent third quarter, putting Canadian output on track to expand 3% in 2017, the fastest pace of growth in six years. The solid economy is reflected in a strong labour market which created an average of 33k jobs/month in the last 12 months, the best performance in a decade. Wages and salaries are also growing at the fastest pace in years and it's a matter of time before that translates to a higher annual core inflation rate. Fiscal stimulus and minimum wage hikes in some provinces should boost growth next year. So, while the central bank suggested it would remain in pause mode for a while, strong data may eventually force its hand early next year.

Canada: Strong labour markets

Unemployment rate



NBF Economics and Strategy (data via Statistics Canada)

Update NBF Profile's Asset Allocation:

With global economic growth and inflation firming up, higher short-term interest rates are to be expected as the Federal Reserve and the Bank of Canada continue to normalize their respective monetary policy. Therefore, we find that the path of least resistance for longer-term bond yields will be up over the next five years. Because duration risk is at historical levels, such an event could likely entail negative nominal returns in the first few years, before stabilizing around coupon rates, leaving the annualized rate of return well below its long-term historical average. At the same time, after eight years of exceptional returns during the financial crisis recovery, we find that equity markets are not a bargain anymore, and we expect an annualized total return of about 6%, on average, for U.S. and Canadian equities over the next five years. This is lower than the long-term historical growth rate.

All in all, as traditional portfolio returns will be lower than in the past, strategies aiming at higher absolute returns or less volatility should be contemplated at this point. As such, we advocate the inclusion of more alternative asset classes. Non-traditional fixed-income funds, such as those linked to interest rate spread strategies, unconstrained global bond funds or structured products can help you offset interest rate risks. To limit volatility and downside, idiosyncratic risk should be diversified with alternative strategies, such as hedge funds, investments linked to infrastructure or structured products or commodities.

We thus increase the maximum allowed weight in the alternative asset class for Income, Conservative and Balanced client profiles.

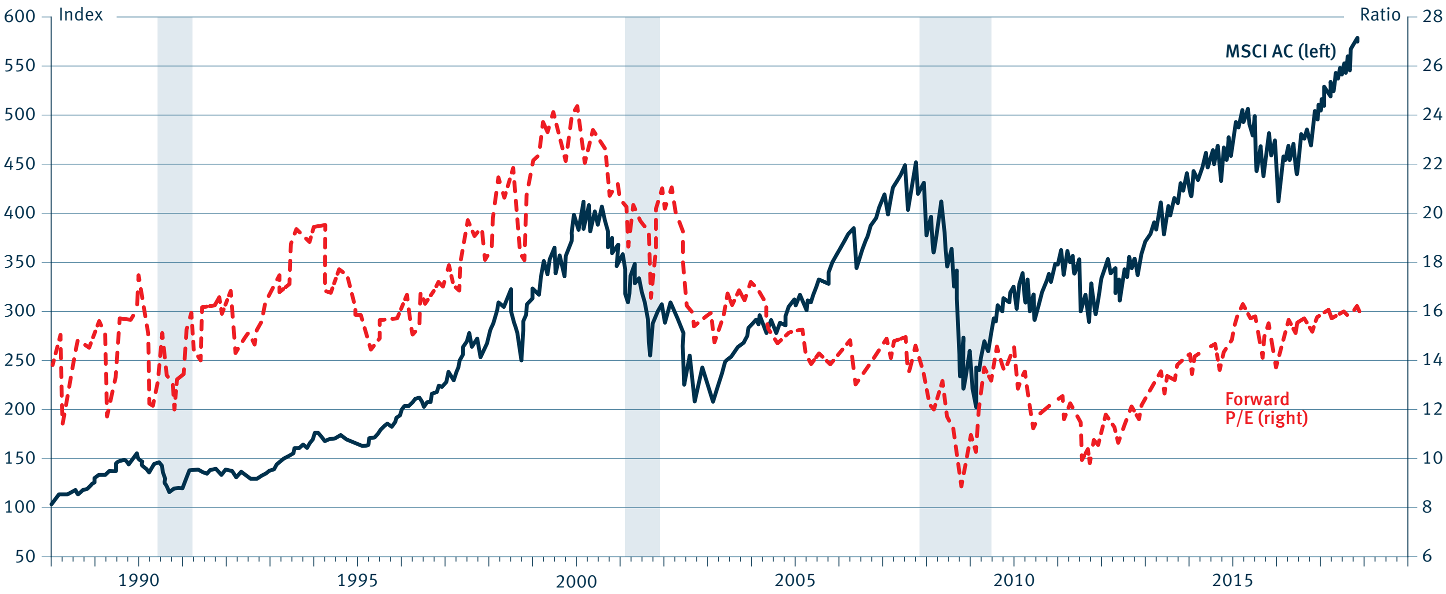
Should you have any questions, please contact your Investment Advisor.

Financial Markets

Global equities continue to do very well. The MSCI All Country Index is up more than 3% so far in Q4, with positive contributions from all major regions of the world. Importantly, the equity rally remains fuelled by better-than-expected profits. We expect this state of affairs to last, as long as economic indicators keep beating expectations.

Global equities: Record high with stable P/E

MSCI AC and its 12-month-forward P/E



NBF Economics and Strategy (data via Datastream)

Investment Strategy

Economic activity remained buoyant in the last quarter, and there is no indication that the trend will falter in 2018 – barring any unforeseen shock. For one, consumer confidence has only been this high twice since 1967 and, at these levels, enthusiasm usually persists for two years before the economy overheats and goes into recession. Additionally, job creation is strong, and the manufacturing and services sectors remain solidly anchored in expansion territory. On this basis, despite expensive valuations in certain markets, the macroeconomic environment continues to make the case for an overweight in equities over bonds.

For fixed income, good economic numbers are emboldening the Fed to continue its path of monetary policy tightening. While inflation figures remain low, we believe 2018 will finally be the year in which wage inflation will eventually take off, putting upward pressure on the medium/long-term rates. On our side of the border, the Bank of Canada may surprise markets; the expectations for a rate hike seem too low, as the economy is set to continue the positive momentum created by the after-oil rebound. Consequently, we suggest a short-duration position for the fixed income exposure, favouring U.S. bonds over Canadian ones.

In currencies, the loonie should continue to move at the mercy of rates differential and oil prices. However, we think that crude oil will be range-bound in the next quarters as prices, if they continue the current trend, will be prone to suffer from a U.S. shale oil ramp up in activity. This resistance in energy prices points toward a non-directional trading range for the currency pair.

On the equity side, we believe Canadian equities continue to offer a better alternative, value-wise. Their bias towards cyclical sectors makes them better geared to the ongoing global synchronized upswing in economic activity. In addition, rising yields also help financials, which represent close to a third of the S&P/TSX. Although a potential U.S. tax reform could propel the S&P 500 higher over the short-term, most of the news is already priced-in and their already-elevated valuation multiples imply limited upside relative to Canada.

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%	9.0%	-1.0%
Fixed income (duration: 5.25 years)[1]	60% to 100%	70.0%	65.0%	0.0%
Canadian equities	0% to 30%	8.0%	8.5%	0.5%
U.S. equities		8.0%	8.5%	0.5%
Foreign equities		4.0%	4.0%	0.0%
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%	8.0%	-1.5%
Fixed income (duration: 5.25 years)[1]	45% to 80%	55.0%	50.5%	0.0%
Canadian equities	20% to 45%	14.0%	15.0%	1.0%
U.S. equities		14.0%	14.5%	0.5%
Foreign equities		7.0%	7.0%	0.0%
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%	8.0%	-1.0%
Fixed income (duration: 5.25 years)[1]	30% to 65%	40.0%	35.5%	0.0%
Canadian equities	30% to 65%	18.0%	19.0%	1.0%
U.S. equities		18.0%	18.5%	0.5%
Foreign equities		9.0%	9.0%	-0.5%
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%	7.0%	-1.0%
Fixed income (duration: 5.25 years)[1]	20% to 45%	30.0%	26.0%	-0.5%
Canadian equities	40% to 75%	22.0%	23.0%	1.0%
U.S. equities		22.0%	22.5%	0.5%
Foreign equities		11.0%	11.5%	0.0%
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%	6.5%	-1.5%
Fixed income (duration: 5.25 years)[1]	0% to 30%	15.0%	11.5%	0.0%
Canadian equities	55% to 100%	26.0%	27.0%	1.0%
U.S. equities		26.0%	26.5%	0.5%
Foreign equities		13.0%	13.5%	0.0%
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

	2016	2017	Forecast 2018	Forecast 2019
Gross Domestic Product %				
Canada	1.4	3.0	2.5	1.5
U.S.	1.5	2.2	2.4	2.0
Inflation %				
Canada	1.4	1.6	2.3	2.1
U.S.	1.3	2.1	2.2	2.2

	December 2017		June 2018		December 2018	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-Bills, 91-Day)	0.96	1.36	1.68	1.74	1.96	1.86
10-year bond yields	1.97	2.45	2.5	2.75	2.7	2.90
30-year bond yields	2.34	2.86	2.84	3.12	2.98	3.24
Canadian dollar	US$ 1.25		US$ 1.27		US$ 1.32	