Building your financial future

Investment Strategy

March 2013

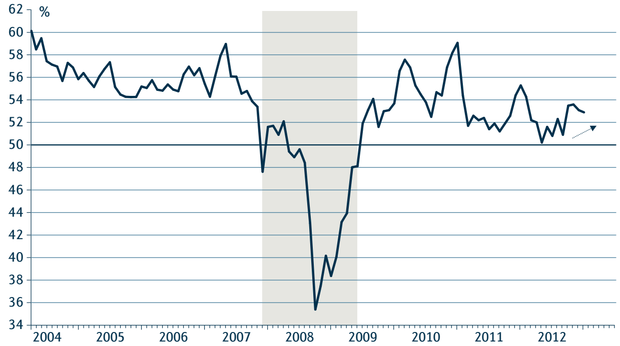
Global Economy

Euro-zone economic indicators remain disappointing and backlash against austerity has been changing the political landscape in some countries, creating uncertainty. On the other hand, central banks across the OECD are still pledging to keep liquidity flowing in support of business and consumer confidence, and the resulting cap on credit stress is conducive to improvement of the economy. Meanwhile, China's new leaders have restated Beijing's commitment to wealth creation, but in a way that is more sustainable for the environment and better distributed in the population.

With China's financial markets working well, its economic expansion can be expected to remain relatively strong, in excess of 7% this year. Though the euro zone will be a no-show in the growth column in 2013, its doldrums will stall neither the emerging economies nor many OECD countries, such as the U.S. and Canada. All in all, we remain comfortable with our current 2013 global growth forecast of about 3.3%, a couple of ticks better than last year.

World: Economy remains resilient

World PMI diffusion index (manufacturing and services)



NBF Economy & Strategy (data via Bloomberg)

In this issue

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

United States

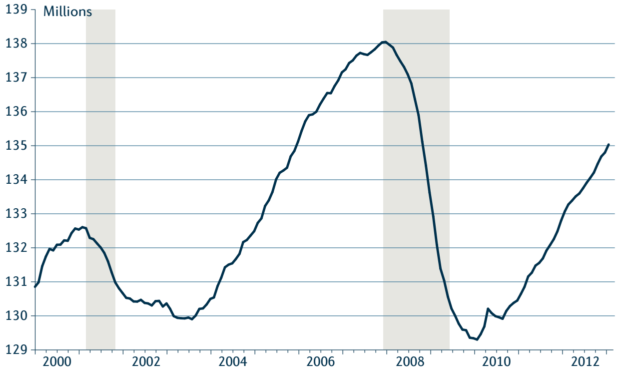
United States

Congress kept investors guessing until the last possible moment but finally avoided sending the economy over a fiscal cliff. Despite the expiration of some tax holidays in January, the U.S. expansion can be expected to continue. Real GDP, after stalling in the fourth quarter of last year, is likely to have accelerated in the first quarter of the new year.

Much of the improvement is driven by hiring. The labour market is revving up, adding 610,000 payroll jobs in the last three months. In addition, consumers are enjoying a financial obligations ratio near a 30-year low. Refinancing has been accelerated by attractive mortgage rates, making an already-low debt burden even more manageable. Also not to be underestimated is the household wealth effect of rising stock prices and property values. Home prices, which according to the Case-Shiller index are up more than 6% from the trough of January 2012, have ample room for further gains in 2013: demand continues to improve, as shown by a clear uptrend in resales, while supply remains limited. In short, fiscal issues aside, there are good things happening in the United States. We expect the world's largest economy to keep expanding.

U.S.: Labour market revving up

Total payroll employment



NBF Economy & Strategy (data via BLS)

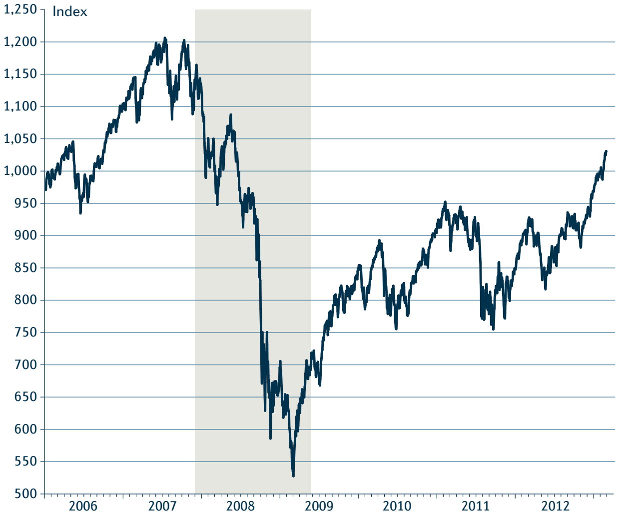
Financial Markets

Financial Markets

Global financial markets have rebounded significantly in recent weeks. The MSCI All Country index is up more than 8% from the beginning of the year, with an overwhelming majority of its 45 country constituents showing a positive return over 2013 to date. And although this all-important equity benchmark is currently at its highest level since mid-2008, its valuation remains below the long-term average. Its ratio of price to forward earnings is less than 14 and its dividend yield is 2.63%, leaving global equities still attractive relative to the bond market. The release on February 20 of the minutes of the January meeting of the Federal Open Market Committee triggered speculation that the Fed might disengage sooner than expected from quantitative easing, i.e. from its purchases of Treasuries, a development that furrowed brows on the stock market. Equity investors were accordingly relieved when Fed chairman Ben Bernanke, in a dovish presentation to Congress of the Fed's Monetary Policy Report, reiterated his commitment to the current monetary stance and the Fed's program of asset purchases. So at this point, the Fed remains supportive of the stock market.

Financial markets: Global equities highest since 2008

MSCI All Country index, local currency

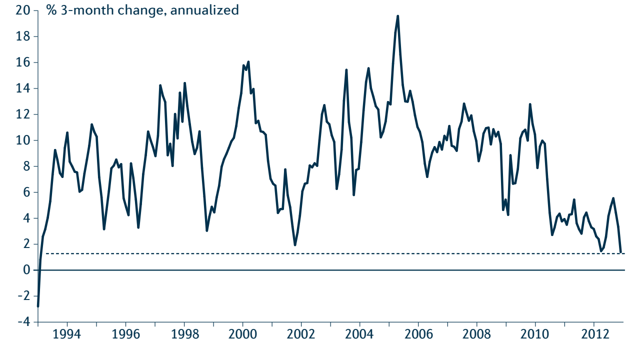


NBF Economy & Strategy (data via Datastream)

Canada

Canadian GDP grew 0.6% annualized in Q4, leaving 2012 growth at just 1.8%. It was the weakest annual showing since 2009, trailing the U.S. (2.2%) for the first time in six years. We expect domestic demand to remain soft this year, braked by stricter rules for first-time homebuyers, fiscal austerity in a number of provinces and relatively weak pricing for Canadian energy exports. Though factory exports are likely to take up some of the slack, the continuing strength of the Canadian dollar will preclude spectacular gains. All things considered, we expect Canadian GDP growth of just 1.5% in 2013. This sluggishness can be expected to keep the Bank of Canada from raising rates any time soon. Reacting to a string of soft Canadian economic reports, our central bank recently acknowledged that its current monetary stance "would likely remain appropriate for a period of time." This is welcome news for business investment and households. The latter seem to be in a deleveraging phase – consumer credit has been growing more slowly than at any time in the last 20 years.

Canada: Consumer credit growth at a 20-year low



NBF Economy & Strategy (data via Statistics Canada)

Canada

Investment Strategy

The year 2013 began with a bang for risk assets. Due to continuous improvement of the economy and the strong commitment of the Fed to support the labour market and the recovery of the housing sector with accommodative monetary measures, U.S. stock exchanges had a strong start. Four years after bottoming out, the Dow Jones set a new record in March and is already showing an increase of over 10% since the beginning of the year. In parallel, the renewed enthusiasm for risk was felt on credit spreads in the first quarter and bond yields have continued their slow recovery begun in July 2012.

Certainly after a rally of more than 15% since the trough in November of last year, the U.S. stock markets are not immune to correction, but unlike the last three years which have all experienced falls of more than 10%, we believe that this time any pullback will be lighter and present an opportunity to increase portfolio risk. Indeed, the market fundamentals remain healthy (market valuation below historic means, low borrowing rates, controlled inflation, high dividend yields) and the strengthening of the U.S. private economy will partly offset the negative effect of the sequester fiscal cuts. Therefore the equity premium demanded by investors to hold risky assets should continue to decline and support stock prices in the coming months.

We maintain an overweight in equities versus bonds. However, some tactical changes were implemented to reflect the momentum of the best areas of the market. In the stock markets, believing that U.S. equities will continue to take the lead in the short term, we have increased the weight of the United States by reducing somewhat our overweight for Canada and emerging markets. In an environment favourable to risk, characterized by an acceleration of activity in the manufacturing and housing sectors, increasing global demand is generally beneficial to commodity-related markets and we believe that Canada will continue to catch-up. In the shorter term, however, the vitality of the U.S. dollar against all currencies has a negative impact on the price of raw materials. This is particularly palpable on the price of gold and its impact on Canadian gold shares is visible, the latter showing in mid-March a decrease of nearly 16% since the beginning of the year.

In terms of fixed income, the expected returns from low interest rates are simply not attractive and we have slightly increased our underweight. First, with inflation at around 2%, real yields on benchmark securities are currently negative. In addition, the risks are more and more skewed to the downside for bondholders as the duration of the benchmark, that is the price sensitivity of a bond to a small rise in interest rates, is too high compared to the yield to maturity of bonds. In addition, as credit spreads have narrowed to near their historic lows, we find investment grade debt increasingly expensive and we lowered our positioning to a neutral weighting. However, we maintain our preference for high-yield issuers which should continue to benefit from an improving U.S. economy.

Asset Mix

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 very low.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	10.0%	10.0%	-1.0%
Fixed-income (duration: 5.7 years)[1]	60% to 100%	70.0%	66.0%	-1.0%
Canadian equities		10.0%	11.5%	-0.5%
U.S. equities	0% to 30%	5.0%	7.0%	2.5%
Foreign equities		5.0%	5.5%	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 15%	5.0%	5.0%	-0.5%
Fixed-income (duration: 5.7 years)[1]	50% to 80%	60.0%	56.0%	-1.0%
Canadian equities		20.0%	22.0%	-1.0%
U.S. equities	20% to 45%	7.5%	9.0%	2.5%
Foreign equities		7.5%	8.0%	0.0%

Balanced Portfolio

Investor Profile: You give equal weight to income and capital growth. You can tolerate moderate volatility to ensure the growth of your capital, but you prefer having a portfolio with a significant exposure to fixed-income securities for reasons of stability. Your tolerance for risk is average.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	5.0%	4.0%	-1.0%
Fixed-income (duration: 5.7 years)[1]	30% to 65%	45.0%	41.0%	-1.0%
Canadian equities		25.0%	27.0%	-1.0%
U.S. equities	30% to 65%	10.0%	12.0%	3.0%
Foreign equities		10.0%	11.0%	0.0%
Alternative investments[2]	0% to 15%	5.0%	5.0%	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%	0.0%	0.0%	-0.5%
Fixed-income (duration: 5.7 years)[1]	25% to 45%	35.0%	30.5%	-1.5%
Canadian equities		25.0%	27.0%	-1.0%
U.S. equities	40% to 75%	15.0%	17.0%	3.5%
Foreign equities		15.0%	15.5%	-0.5%
Alternative investments[2]	0% to 20%	10.0%	10.0%	0.0%

Maximum Growth

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 very high.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 30%	0.0%	0.0%	0.0%
Fixed-income (duration: 5.7 years)[1]	0% to 30%	20.0%	16.0%	-2.5%
Canadian equities		25.0%	27.0%	-1.0%
U.S. equities	55% to 100%	20.0%	21.5%	4.0%
Foreign equities		20.0%	20.5%	-0.5%
Alternative investments[2]	0% to 25%	15.0%	15.0%	0.0%

1) Includes conventional and real return bonds. Benchmark = 75% DEX Universe Index, 25% SC RRB Index.
2) Includes hedge funds and real estate. Benchmark = 50% Tremont Hedge Fund Index, 50% S&P TSX Cap REIT Index.

Forecast

	2011	2012	Forecast 2013	Forecast 2014
Gross Domestic Product %				
Canada	2.6	1.8	1.5	2.4
U.S.	1.8	2.2	1.8	2.7
Inflation %				
Canada	2.9	1.5	1.1	1.9
U.S.	3.1	2.1	1.8	2.2

	March 2013		December 2013		December 2014	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-Bills, 91-Day)	0.96	0.07	0.98	0.09	1.93	0.11
10-year bond yields	2.00	1.92	2.49	2.40	3.07	2.87
30-year bond yields	2.58	3.09	2.98	3.42	3.39	3.81
Canadian dollar	U.S.$0.97		U.S.$0.96		U.S.$1.01	

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