March 2018
Building your financial future

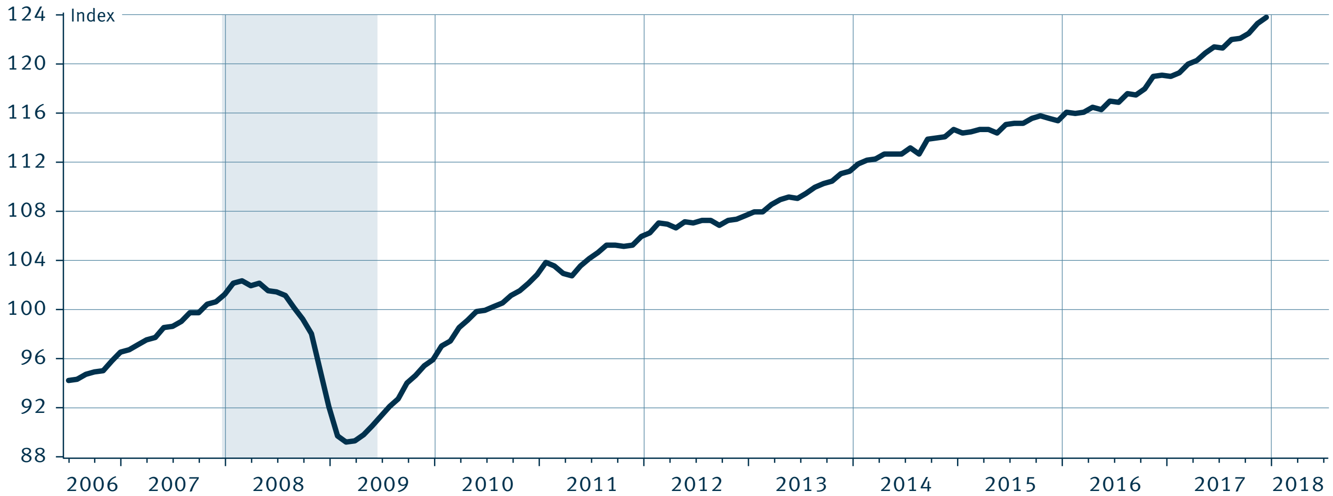
Investment Strategy

World

It's becoming clearer why world GDP growth accelerated sharply last year. The latest data from the CPB showed trade volumes not only reaching a new record but also growing in 2017 at 4.5%, the fastest pace since 2011. Improving trade allowed export powerhouses in both advanced and emerging markets to flourish. Industrial production in the OECD grew at the fastest pace in years, courtesy of the U.S., the Eurozone and Japan. All in all, we continue to expect the global economy to replicate, if not top, last year's growth print. Slightly tighter monetary policy in some economies are unlikely to derail the ongoing improvement in domestic demand, while exporters should continue to benefit from buoyant world trade. Our forecast for the world economy to grow 3.8% this year assumes that protectionist forces are kept at bay.

World: Industrial output at a record

Industrial production in volume terms



NBF Economics and Strategy (CPB data via Datastream)

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

In this issue

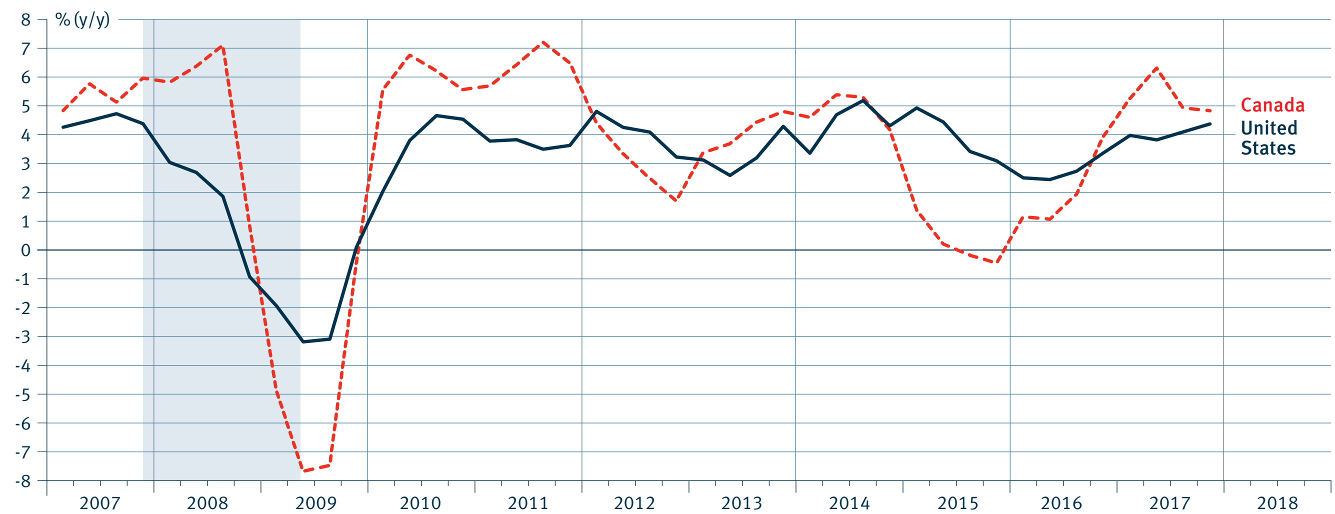
Canada

Canada's GDP expanded at an annualized pace of 1.7% in the fourth quarter last year, allowing for a 3% growth print for 2017, the best annual performance in six years. While trade was an expected drag on growth in Q4 due to surging imports, domestic demand provided more than an offset, thanks to gains for consumption, government spending, business investment and residential construction. Consumption found support from solid gains in real disposable incomes, which offset the impact of a rising savings rate. Nominal GDP grew for an eighth consecutive quarter, which will pad government coffers further.

Barring the implementation of protectionist policies stateside, Canadian exporters should enjoy positive spillovers from the recently announced ramp-up in U.S. fiscal stimulus. Domestic demand will also find support as business investment continues to recover, consumers enjoy higher incomes—courtesy of housing wealth effects and a strong labour market—and provincial governments ramp up spending ahead of elections in Ontario and Quebec. Rising inflation pressures should prompt the Bank of Canada to raise interest rates further, although the extent of monetary tightening will depend on the outcome of NAFTA negotiations.

Canada: Perspective on nominal GDP

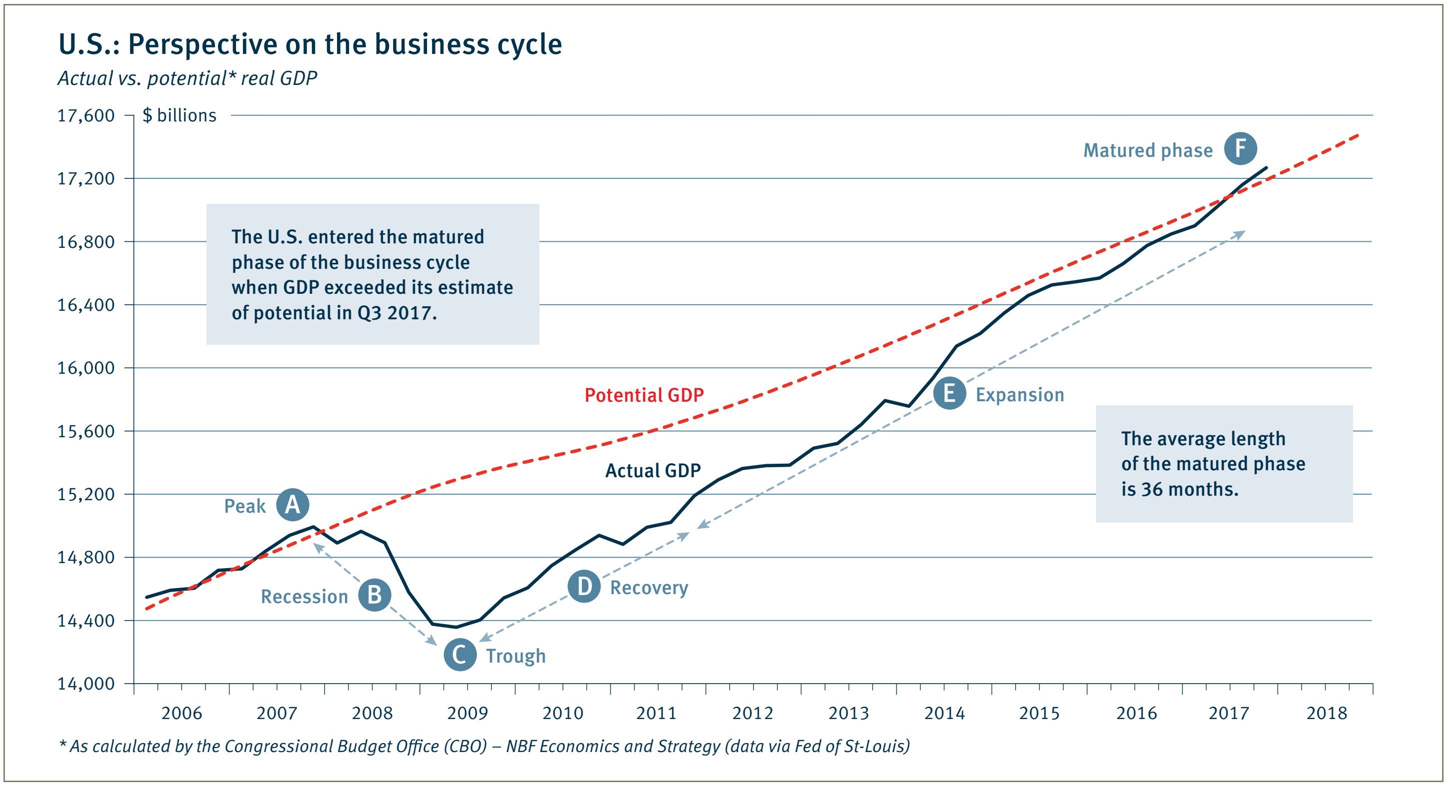
Nominal GDP growth



NBF Economics and Strategy (data via Statistics Canada and Datastream)

United States

As if tax cuts were not enough, the U.S. Congress opted for another dose of fiscal stimulus, this time by increasing spending caps. We estimate the extra spending will boost growth by a little less than half a percentage point, which explains upgrades to our U.S. GDP growth forecast to 2.8% in 2018. The budget deficit, which is now projected to soar next year past US$1 trillion (more than 5% of GDP), will have to be addressed down the road. If recent developments in the bond market are any indication, a larger U.S. budget shortfall could prompt investors to demand even higher yields on U.S. Treasuries at a time when, according to the Congressional Budget Office estimates, the output gap is positive for the first time in a decade — meaning there is no excess slack left in the economy.



Investment Strategy

The U.S. equity market continues its growth momentum set in the previous quarters as employment remains strong, and the manufacturing and services sectors are still solidly in expansion territory. However, inflation is showing signs of accelerating, which increases fears that the Fed will tighten its monetary policy faster than initially expected by investors. This assumption triggered an equity correction in February after multiple quarters of uncanny calm and stability in the asset class. Despite higher realized volatility and political risks coming back to the forefront via protectionist policies, we still favour equities over their fixed-income counterparts as the selloff pushed stock valuations closer to their long-term average, and the economic backdrop is still conducive to earnings growth, which is also enjoying the added benefit of a corporate tax cut in the U.S.

In fixed income specifically, the new Fed Chairman, Jerome Powell, should follow the policy course set by his predecessor and pursue a measured and gradual approach towards future rate hikes. Consequently, as rates are heading higher for “good reasons”—a combination of rising growth prospects tied to an appropriate central bank response—we advise staying underweight in government bonds or investing in short-duration products. We also favour non-traditional or unconstrained fixed-income solutions.

Currency-wise, we believe the U.S. dollar will head lower on the medium- to long-term horizon. It’s not so much that we view the currency or the country’s economic situation as weak, but that other FX pairs have a better outlook as central banks are shifting their stance towards a more aggressive monetary policy as synchronized growth takes hold. For the Canadian dollar, all eyes are set towards NAFTA negotiations, and the future value of the currency is dependent on political risks as well as the direction of domestic crude oil prices, which are currently trading at a discount caused by reduced export capabilities. There is also uncertainty about the state of the housing sector, which weighs down potential foreign investments to the country. However, most of these developments are now priced-in and we have a neutral view towards the currency for the next quarter. Nevertheless, as the market expects that an agreement on NAFTA will eventually be reached, any failure on that front would send the value of the currency much lower.

MODEL PORTFOLIOS

Income Portfolio	Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
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.	Cash equivalents	0% to 20%	5.0%	7.5%	-1.5%
	Fixed income (duration: 5.25 years)[1]	60% to 100%	70.0%	65.0%	0.0%
	Canadian equities	0% to 30%	8.0%	9.0%	0.5%
	U.S. equities		8.0%	9.0%	0.5%
	Foreign equities		4.0%	4.5%	0.5%
	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.	Cash equivalents	0% to 20%	5.0%	6.5%	-1.5%
	Fixed income (duration: 5.25 years)[1]	45% to 80%	55.0%	50.0%	-0.5%
	Canadian equities	20% to 45%	14.0%	15.5%	0.5%
	U.S. equities		14.0%	15.5%	1.0%
	Foreign equities		7.0%	7.5%	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.	Cash equivalents	0% to 20%	5.0%	6.0%	-2.0%
	Fixed income (duration: 5.25 years)[1]	30% to 65%	40.0%	34.0%	-1.5%
	Canadian equities	30% to 65%	18.0%	20.0%	1.0%
	U.S. equities		18.0%	20.0%	1.5%
	Foreign equities		9.0%	10.0%	1.0%
	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.	Cash equivalents	0% to 25%	5.0%	6.0%	-1.0%
	Fixed income (duration: 5.25 years)[1]	20% to 45%	30.0%	25.0%	-1.0%
	Canadian equities	40% to 75%	22.0%	23.5%	0.5%
	U.S. equities		22.0%	23.5%	1.0%
	Foreign equities		11.0%	12.0%	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.	Cash equivalents	0% to 30%	5.0%	5.5%	-1.0%
	Fixed income (duration: 5.25 years)[1]	0% to 30%	15.0%	10.5%	-1.0%
	Canadian equities	55% to 100%	26.0%	27.5%	0.5%
	U.S. equities		26.0%	27.5%	1.0%
	Foreign equities		13.0%	14.0%	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

	2016	2017	2018 (Forecast)	2019 (Forecast)
Gross Domestic Product %				
Canada	1.4	3.0	2.6	1.8
U.S.	1.5	2.3	2.8	2.3
Inflation %				
Canada	1.4	1.6	2.3	2.1
U.S.	1.3	2.1	2.5	2.3

	June 2018		December 2018		December 2019	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-Bills, 91-Day)	1.46	1.60	1.88	2.10	2.21	2.85
10-year bond yields	2.51	2.97	2.68	3.17	3.05	3.38
30-year bond yields	2.60	3.19	2.74	3.36	3.08	3.52
Canadian dollar	US$ 0.80		US$ 0.83		US$ 0.82	