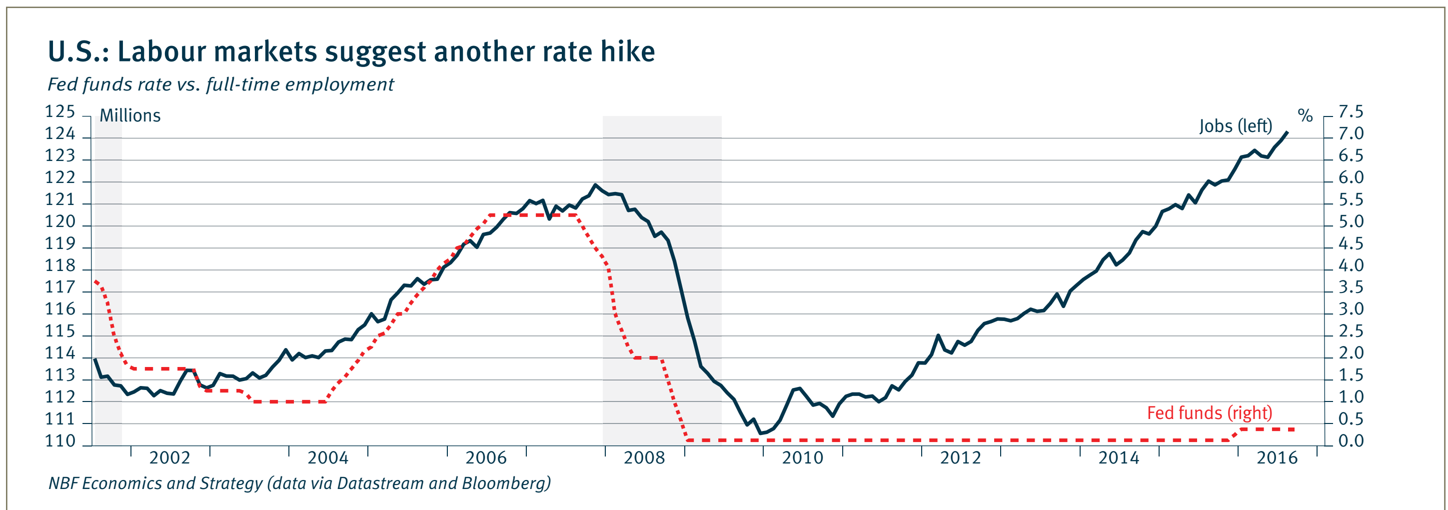
September 2016
Building your financial future

Investment Strategy

Global Economy

After a weak performance in H1, the U.S. economy is set to expand 3% in H2 on the back of a resilient labour market: Full-time jobs are at a record high and wage and salary disbursements in the private sector are rising at a strong clip. Though we have brought forward the timing of a rate hike to December in light of the Fed's hawkish talk, we expect that move to be followed by a long pause. In other words, monetary policy is unlikely to turn restrictive anytime soon. For 2017, we peg growth at 2% in the U.S., 6.3% in China and 1.3% in the Eurozone. Global growth of 3.3% next year should help support commodity prices (WTI in the $50 range).

The Canadian economy just had its worst quarter since the 2009 recession (-1.6% in Q2), but a quick rebound is in the cards. Oil production is reportedly rising again, and there are also signs American manufacturers are rebuilding inventories. Indeed, after contracting last quarter, U.S. manufacturing output is now on track to rise in Q3 at the fastest pace in over two years and that's likely to translate into higher exports of Canadian manufacturing goods, including autos. A pick-up in the pace of aircraft shipments by Bombardier will also help exports through year-end courtesy of the C-series. Still, the transition of the Canadian economy is far from over; a development that will keep potential GDP growth subdued. We see Canada expanding 1.8% in 2017, up from 1.2% this year.



In this issue

Global Economy 1
Financial Markets 2
Housing Market 2
Investment Strategy 3
Model Portfolios 4
Forecast 4

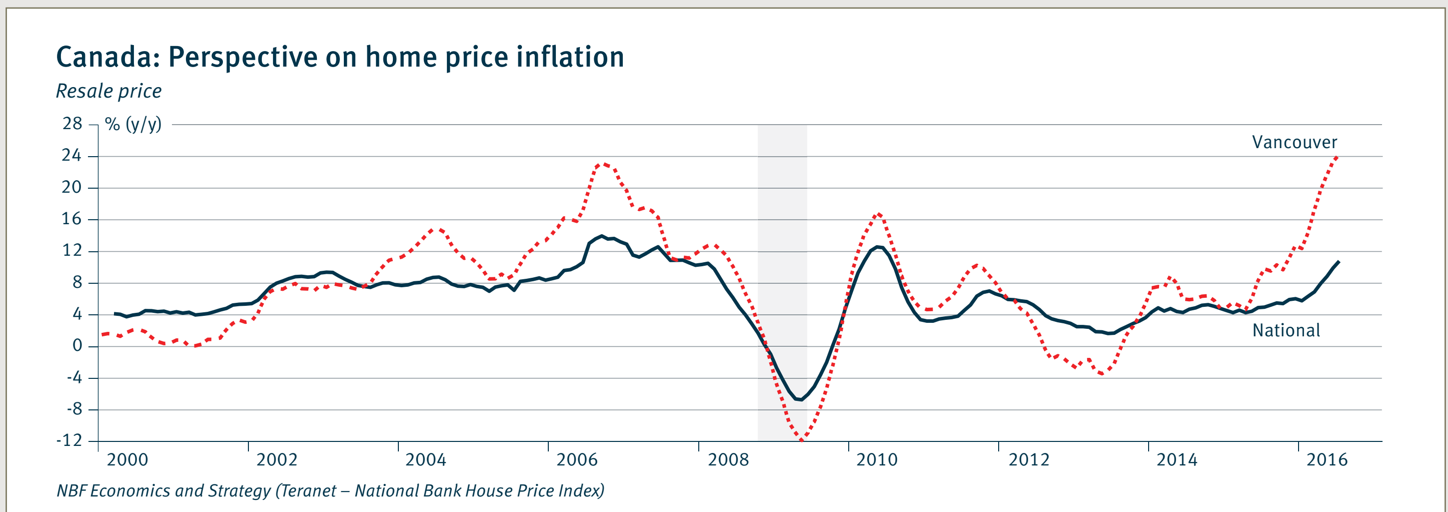
NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

Financial Markets

Financial markets were caught flat-footed by the June 23 U.K. vote to exit the European Union. Year-to-date gains of many equity indexes were erased in a day, global bond yields fell to record lows and the U.S. dollar surged again. How quickly things can change. At this writing the MSCI is up no less than 10% from its June 27 low, for a year-to-date gain of 3.7%. It was the third time in a year that markets shrugged off concern about a deteriorating global backdrop.

Housing Market

The dichotomy in the Canadian home resale market continues so far in 2016: large gains in the Vancouver and Toronto areas have been driving the national home price index higher (+11%), but outside these regions, prices have been flat over the last year. Looking ahead, we expect the Vancouver market to cool after the recent increase of the minimum down payment required for CMHC-insured homes and the implementation of a 15% property transfer tax on foreign purchases. We see prices dropping 5% in the coming quarters. Vancouver's red hot labour market (employment up 7.4% on a y/y basis) should help limit the downside. We see prices rising only 0.7% at the national level in 2017.



Investment Strategy

As the initial shock to the surprise Brexit referendum outcome waned, markets responded with renewed vigour as equities more than compensated the losses following the vote. However, in the U.S., this performance generated further financial ratio expansion, as companies have struggled to generate momentum in growing their earnings, which have remained flat on a year-over-year basis for a couple of quarters now. Reduced profitability has been a consequence of a strong U.S. dollar crippling exports in addition to a domestic economic soft patch witnessed in the second quarter.

In light of the underlying data and global uncertainty this summer in the immediate aftermath following the Brexit votes, the Fed deemed a hike was ill-timed and decided to postpone, once again, its plans to tighten its monetary policy. However, the economy is expected to rebound in the third quarter and employment figures show a constant improvement of labour markets that more than compensates for demographic growth, a situation that could potentially translate to increased wage inflation. Consequently, the Fed seems poised to hike once by the end of 2016.

In such a scenario, one should carefully choose what fixed income products to invest in. We suggest taking a defensive position duration-wise while being more aggressive on the credit side. This strategy has the benefit of offering higher yields while mitigating the impact of a potential hike. One way to invest in longer duration bonds would be through Treasury Inflation-Protected Securities (TIPS), which would offer better prospects than their plain-vanilla counterparts by limiting the impact of rising inflation on real returns. On the equity side, we think the asset class will face some headwinds. Valuations are not cheap and, after a 15% increase since the lows of February, markets are due for a consolidation. The potential monetary policy tightening also risks weighing on performance if the Fed decides to act. As a consequence, we suggest keeping some liquidity on hand to invest when opportunities present themselves.

MODEL PORTFOLIOS

Portfolio	Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
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.	Cash equivalents	0% to 20%	5.0%	6.5%	1.5%
	Fixed-income (duration: 5,25 years)[1]	60% to 100%	70.0%	66.0%	0.0%
	Canadian equities	0% to 30%	7.5%	8.5%	-1.0%
	U.S. equities		7.5%	9.0%	0.0%
	Foreign equities		5.0%	5.0%	-0.5%
	Alternative investments[2]	0% to 10%	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%	6.0%	1.5%
	Fixed-income (duration: 5,25 years)[1]	45% to 80%	55.0%	51.0%	0.0%
	Canadian equities	20% to 45%	14.0%	15.0%	-1.5%
	U.S. equities		14.0%	15.5%	0.0%
	Foreign equities		7.0%	7.5%	0.0%
	Alternative investments[2]	0% to 15%	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%	3.0%
	Fixed-income (duration: 5,25 years)[1]	30% to 65%	40.0%	36.0%	0.0%
	Canadian equities	30% to 65%	17.5%	18.5%	-2.0%
	U.S. equities		17.5%	19.0%	-0.5%
	Foreign equities		10.0%	10.5%	-0.5%
	Alternative investments[2]	0% to 20%	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%	0.0%	2.5%	1.0%
	Fixed-income (duration: 5,25 years)[1]	25% to 45%	35.0%	29.5%	1.5%
	Canadian equities	40% to 75%	20.0%	21.0%	-2.0%
	U.S. equities		20.0%	21.5%	0.0%
	Foreign equities		15.0%	15.5%	-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%	0.0%	3.5%	1.5%
	Fixed-income (duration: 5,25 years)[1]	0% to 30%	20.0%	13.5%	2.0%
	Canadian equities	55% to 100%	22.5%	23.5%	-2.5%
	U.S. equities		22.5%	24.0%	-0.5%
	Foreign equities		20.0%	20.5%	-0.5%
	Alternative investments[2]	0% to 30%	15.0%	15.0%	0.0%

1 Dex Universe Index
2 Includes Hedge funds, Global real estate and Infrastructure, and Commodities.

FORECAST

	2014	2015	2016 (Forecast)	2017 (Forecast)
Gross Domestic Product %				
Canada	2.5	1.1	1.2	1.8
U.S.	2.4	2.6	1.6	2.0
Inflation %				
Canada	1.9	1.1	1.5	2.0
U.S.	1.6	0.1	1.2	2.0

	August 2016		December 2016		December 2017	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-Bills, 91-Day)	0.52	0.33	0.46	0.56	0.74	1.10
10-year bond yields	1.02	1.58	1.16	1.70	1.72	2.06
30-year bond yields	1.63	2.23	1.71	2.35	2.13	2.59
Canadian dollar	U.S. $0.76		U.S. $0.74		U.S. $0.75	

National Bank Financial is an indirect wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on the Toronto Stock Exchange (NA: TSX). The particulars contained herein were obtained from sources we believe to be reliable, but are not guaranteed by us and may be incomplete. The opinions expressed are based upon our analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities that may be mentioned herein. National Bank Financial may act as financial advisor, fiscal agent or underwriter for certain companies mentioned herein and may receive remuneration for its services. National Bank Financial and/or its officers, directors, representatives or associates may have a position in the securities mentioned herein and may make purchases and/or sales of these securities from time to time on the open market or otherwise. National Bank Financial is a member of the Canadian Investor Protection Fund (CIPF).