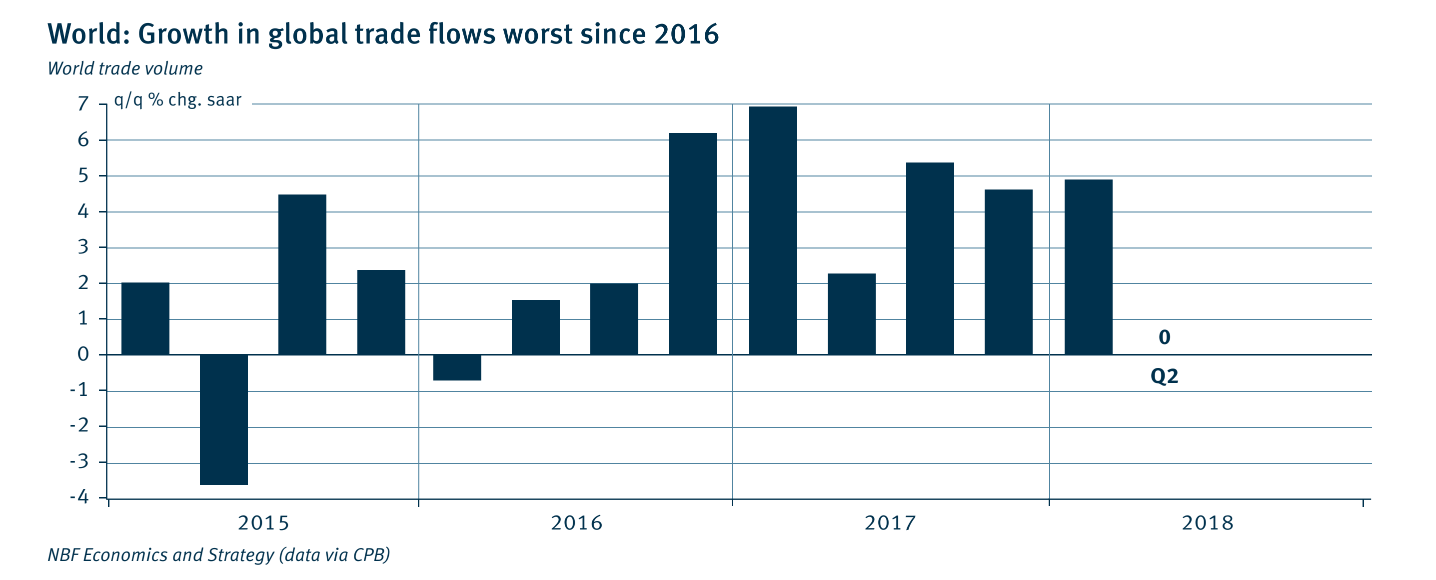
September 2018
Building your financial future

Investment Strategy

World

U.S.-led trade wars seem to be starting to hurt the world economy. The latest CPB data confirm that global trade volume was flat in Q2—the worst quarter since 2016—as U.S. tariffs on steel and aluminum imports and the retaliatory measures of affected trade partners took effect. Emerging economies, highly dependent on trade, were hit hard in Q2. Volume exports declined at 2% annualized. While China's recently announced plan to boost infrastructure spending is good news for commodity prices, the longer-term outlook will depend on the commitment of the large economic powers to the value of globalization. We take solace from the agreement between Chinese and U.S. trade negotiators to map out a road to a solution for their trade impasse before the G20 meeting on November 30 in Buenos Aires, which Mr. Trump and Mr. Xi are scheduled to attend. Growth is set to slow in Q4. Policymakers must now take steps to reaccelerate it in 2019.



NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

In this issue

Canada

A strong performance in the second quarter leaves Canada's economy with little to no slack. Real GDP growth accelerated to 2.9% annualized in the second quarter. Trade contributed to growth for the first time in a year, thanks to surging exports. Domestic demand was also well supported, courtesy of healthy gains for consumption spending, residential investment, government expenditures and business investment. Nominal GDP grew a massive 5.1% annualized, a positive for public finances, corporate profits and labour markets. The Survey of Employment, Payrolls and Hours suggests paid employment in the first half averaged 32,000 net new jobs per month, the fastest pace of job creation since 2000. With the housing market having seemingly shaken off the effects of tighter macroprudential measures, the Bank of Canada can now more confidently tackle mounting inflation pressures with tighter monetary policy. We continue to expect real GDP to grow 2% this year, although our call for 1.9% growth in 2019 assumes Canada can avoid tariffs by striking a new trade deal with the U.S. At this writing, the U.S. and Mexico had a tentative deal in place and considered including Canada as well.

Canada: Perspective on labour-market slack

Unemployment rate

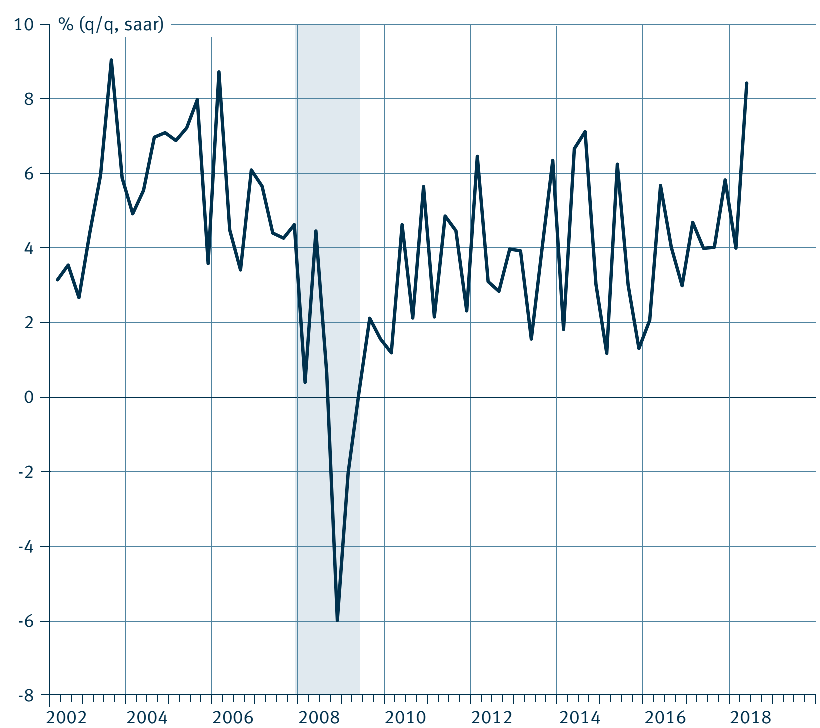
NBF Economics and Strategy (data via Statistics Canada)

United States

The advertised near-term benefits of fiscal stimulus have materialized. U.S. GDP growth accelerated to 4.2% in the second quarter, with tax cuts propping up both consumer spending and business investment. Government outlays also increased. All in all, real final sales, i.e., GDP-excluding inventories, grew at 5.3% annualized. In nominal terms, the Q2 growth was a whopping 8.4%, the strongest since 2006 (see chart). So, the only reason real growth did not top 5% was a drag from inventories. That drag, however, is good news for inventory rebuilding and thus for output. That being said, the Citi economic surprise index for the U.S. has turned negative for only the second time since Mr. Trump's election, an indication of waning momentum. Perhaps the White House will take note and reassess its position on trade. In the meantime, the good news is that the Federal Reserve's forward guidance has become hazier about the path of policy-rate normalization after its next hike.

U.S.: Final sales surge in Q2

Nominal final sales of domestic product



NBF Economics and Strategy (data via Datastream)

Investment Strategy

The political drama in Washington certainly didn't take a vacation this summer, with the combination of an escalating trade feud between the world's two biggest economies and a seemingly precarious Trump administration. However, while this may have caused anxiety for many investors, our focus is more on economic fundamentals, and one can hardly deny that macroeconomic conditions have rarely been this good south of the border. Jobless claims are at their lowest point since the late 60s, consumer confidence is at an 18-year high, the pace of activity in the U.S manufacturing sector rose to its highest level in 14 years and the latest GDP figures show the strongest reading in nearly four years. Although the bulk of media coverage focuses on evermore dramatic stories originating from the White House, let us reiterate that what ultimately matters for risk assets is the state of the economy and companies' ability to generate profits. Therefore, with little recession risk on the horizon, we stand by our cautiously optimistic stance adopted earlier this year, and continue to modestly favour equities over their fixed-income alternatives.

With an economy running above potential and inflation showing signs of acceleration, we should not be surprised with the U.S. Federal Reserve's commitment to gradually bring rates from accommodative to neutral. Similar context on our side of the border, where the Bank of Canada is expected to hike its benchmark rate in October for a third time this year. Such circumstances argue in favour of higher Canadian and U.S. bond yields, which have remarkably stagnated in recent months, in all likelihood contained by investors' caution in this time of trade uncertainty. Our base-case scenario remains one where Canada comes to an agreement on trade with its North American partners, in which case we expect bond yields to resume their slow and steady upward trend. Consequently, we advise staying underweight in government bonds or investing in shorter duration products. We also favour non-traditional or unconstrained fixed-income solutions.

Much like virtually all currencies, the loonie has undeniably fallen victim to the U.S. trade rhetoric and tariff threats over the last quarters, failing to benefit from positive economic surprises in Canada and a healthy fundamental outlook for crude oil. We believe the worst is behind us, and the Canadian dollar should have a clearer path toward appreciation going forward. Still, with NAFTA negotiations looming large, we are playing it safe by suggesting only a small overweight in the Canadian dollar until we get further clarity on that front.

Aside from currencies, the fog of trade war, coupled with country-specific risks in certain emerging economies and ever-surprising profits from corporate America, led to a significant divergence in global equity returns, to the benefit of a dominant U.S. market. Our preference for North American equities over their international alternatives has played well in this context, and we begin the last quarter of 2018 with roughly the same positioning. Indeed, the ability of companies to generate profits is categorical, especially at this point in the cycle, and perspectives for the tech-heavy S&P 500 compares advantageously. The 20% downturn in emerging market stocks makes the region increasingly attractive on a long-term basis. However, we believe prudence and patience is still appropriate for the next few months, as there is little reason to expect an easing of tensions between the U.S. and China before November's mid-term election. To be clear, our base-case scenario remains one where the world's two biggest economies will avoid derailing one another and come to terms. But the road to get there is likely to be winding.

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%	6.0%	-1.5%
Fixed income (duration: 5.25 years)[1]	60% to 100%	70.0%	66.0%	0.0%
Canadian equities		8.0%	9.0%	0.0%
U.S. equities	0% to 30%	8.0%	10.0%	1.5%
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%	5.0%	-1.5%
Fixed income (duration: 5.25 years)[1]	45% to 80%	55.0%	51.0%	0.0%
Canadian equities		14.0%	15.5%	0.0%
U.S. equities	20% to 45%	14.0%	16.5%	1.5%
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%	5.0%	-1.0%
Fixed income (duration: 5.25 years)[1]	30% to 65%	40.0%	35.0%	0.0%
Canadian equities		18.0%	20.0%	0.0%
U.S. equities	30% to 65%	18.0%	21.0%	1.5%
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%	5.0%	-1.0%
Fixed income (duration: 5.25 years)[1]	20% to 45%	30.0%	26.0%	0.0%
Canadian equities		22.0%	23.5%	0.0%
U.S. equities	40% to 75%	22.0%	24.5%	1.5%
Foreign equities		11.0%	11.0%	-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%	5.0%	-0.5%
Fixed income (duration: 5.25 years)[1]	0% to 30%	15.0%	11.0%	0.0%
Canadian equities		26.0%	27.5%	0.0%
U.S. equities	55% to 100%	26.0%	28.5%	1.0%
Foreign equities		13.0%	13.0%	-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	Forecast 2018	Forecast 2019
Gross Domestic Product %				
Canada	1.4	3.0	2.0	1.9
U.S.	1.6	2.2	2.9	2.4
Inflation %				
Canada	1.4	1.6	2.4	2.2
U.S.	1.3	2.1	2.5	2.3

	August 2018 Canada	August 2018 U.S.	December 2018 Canada	December 2018 U.S.	December 2019 Canada	December 2019 U.S.
Rate %						
Short-term rates (T-Bills, 91-Day)	1.53	2.07	1.88	2.31	2.46	2.83
10-year bond yields	2.23	2.86	2.57	3.07	3.10	3.47
30-year bond yields	2.25	3.02	2.63	3.21	3.15	3.57
Canadian dollar	US$ 0.77		US$ 0.78		US$ 0.79	

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