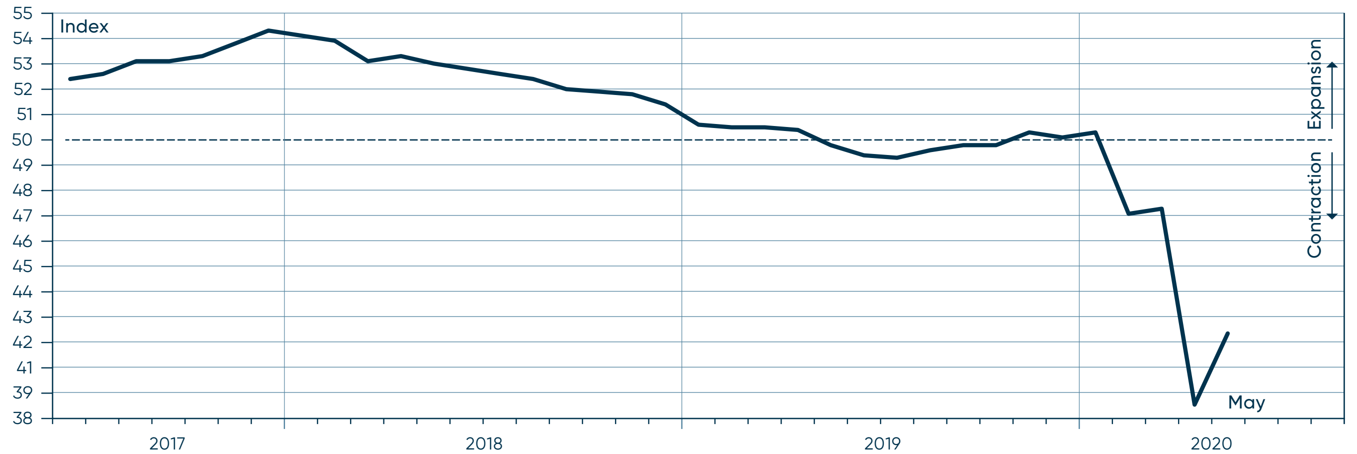
June 2020
Building your financial future

Investment Strategy

World

The recent flattening of the pandemic curve has led several governments to order a gradual reopening of their respective economies. One of the most fundamental arguments for a reopening of the economy has to do with the age distribution of those most likely to succumb to COVID-19. In the Spanish flu pandemic, the people most likely to die were younger workers and their children. Today the mortality rate is highest for those older than 65, i.e., people likely to be outside the labour force. Unless the virus mutates, governments can be justified in re-opening larger segments of the economy while channelling more resources to protect their senior citizens, especially those in nursing homes. After contracting sharply in the second quarter, global economic activity seems set to rebound markedly in the third quarter. The sustainability of recovery remains dependent on the pandemic outcome and fiscal/monetary support.

World: Factory PMI improved but remained deep in contraction territory
Global Manufacturing PMI



NBF Economics and Strategy (Source: Markit via Refinitiv)

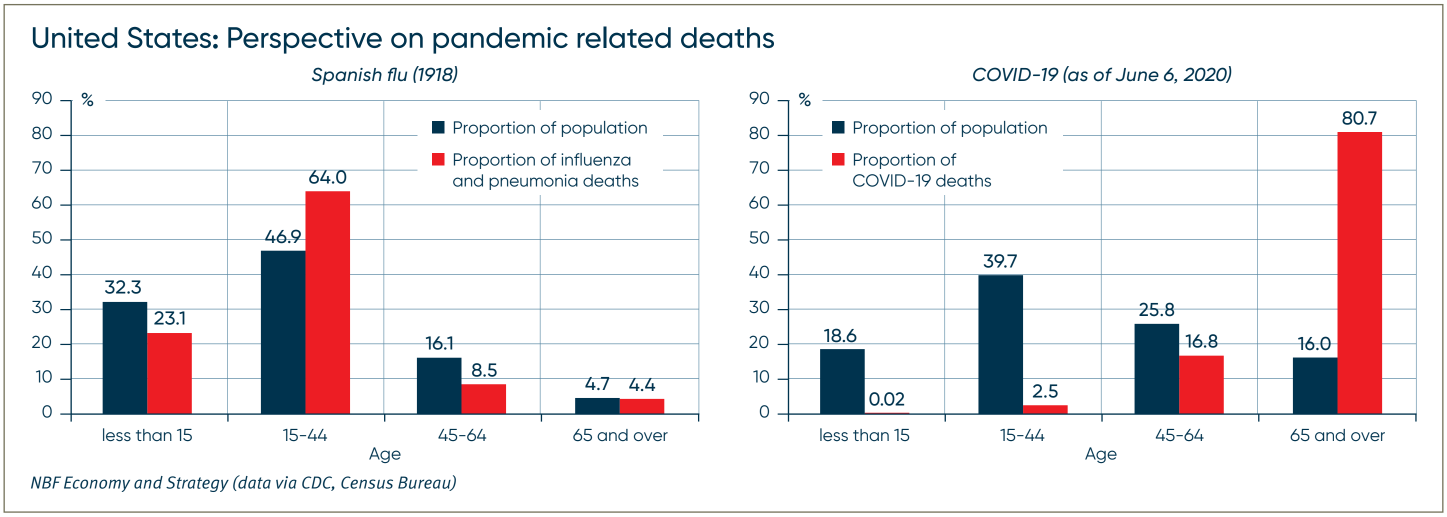
NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

In this issue

World 1
United States 2
Canada 2
Investment Strategy 3
Model Portfolios 4
Forecast 4

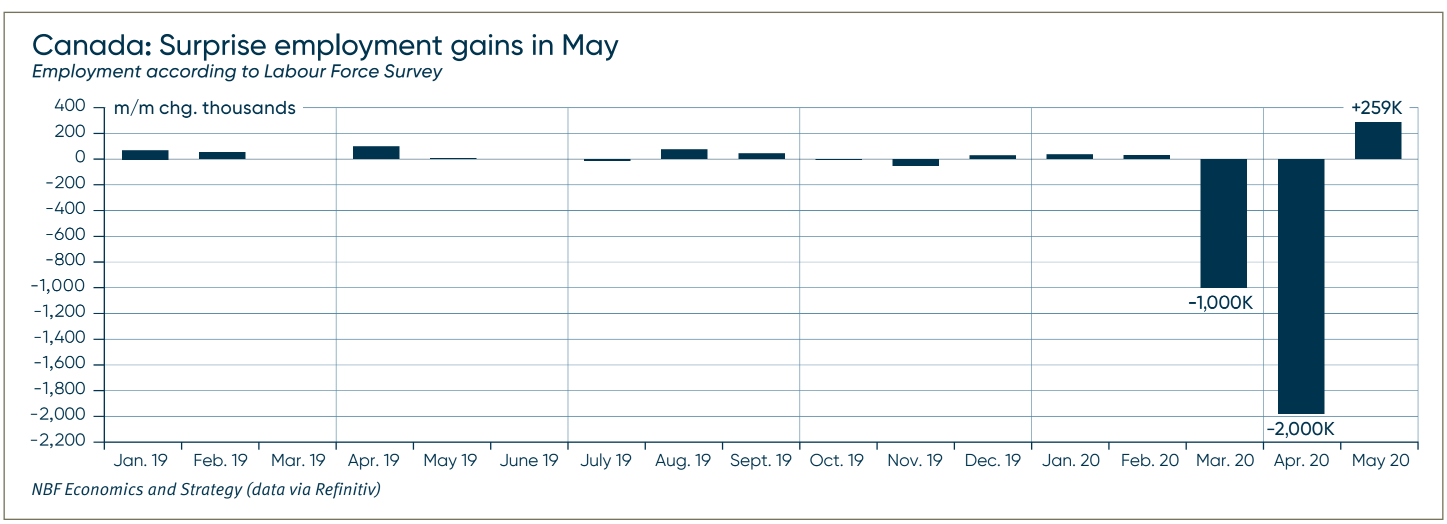
United States

While the U.S. economy remains in a delicate situation, with the second quarter witnessing the largest contraction of GDP and employment since the Great Depression, diminished financial stress courtesy of prompt action by the Federal Reserve allows for optimism about a second-half rebound. After April's record job purge, the U.S. labour market produced yet another surprise, this time in the other direction. The establishment survey showed non-farm payrolls increasing by 2.5 million in May as gains in the private sector more than offset declines in government. Job creation was widespread in the private sector as evidenced by the employment diffusion index, which climbed to its highest level since 2018. Clearly, the U.S. employment recovery has started. While millions of lost jobs during March and April will be recouped in the coming months, a return to February's levels of employment will take a while in part because of new challenges brought by this pandemic.



Canada

While a rebound is likely in the second half of 2020 as more of the economy reopens and firms rebuild inventories, that won't make up for the first-half collapse in economic activity, leaving Canada with the worst annual GDP contraction on record. This is despite unprecedented fiscal and monetary policy stimulus. Even with the start of a recovery in May (net job gains of 290K), employment is still down an astounding 14% from the peak reached last February. Considering ongoing headwinds, we suspect policymakers will add to their already impressive offering of stimulus. We are for now leaving our forecast of -7.1% for Canada's 2020 GDP growth unchanged.



Investment Strategy

After the dramatic plunge in equity markets triggered by a rapidly evolving pandemic and government-imposed lockdowns during the first quarter of the year, Q2-2020 saw one of the most spectacular rebounds in the history of financial markets. As a result, equity indices have recovered a large part of their losses year-to-date, especially south of the border, where the heavy exposure to sectors that are better equipped to face the current economic challenges (technology, healthcare, communication services) has allowed the S&P 500 to significantly outperform its peers. Combined with the resiliency of bond markets, this translates into a more than reasonable performance for balanced portfolios given the circumstances. Decidedly, these last two quarters have served as a prime example of the importance of not giving in to panic in times of market turmoil—a message we can't repeat often enough.

The key factor behind the fast recovery in asset prices is evidently the massive and coordinated response from government bodies: wartime-like fiscal deficits; the fastest monetary easing in history; and, most importantly, strict confinement measures that have proven to be effective in slowing the spread of the virus thus far. While this will certainly not prevent global economic growth from recording its worst contraction in decades, it has laid the groundwork for a recovery in economic activity in the months ahead. The magnitude and speed of the upturn remains highly uncertain, but the strength of the most recent employment reports in both Canada and the United States suggests that the worst is indeed behind us, which is what matters most for stock markets.

We reduced our equity exposure down to neutral early in the crisis but have been reluctant to adopt an outright defensive allocation for reasons we explained in the March edition of the quarterly Investment Strategy report. At the time, we introduced a list of key elements to observe before turning more optimistic with greater conviction, which included points about fiscal policy, credit conditions, and the COVID-19 case trajectory. By early June, all items on our list were officially flashing green. Accordingly, we made a first step back in favour of equity markets by deploying our excess cash position.

Some may question how much upside is left in equity markets after their spectacular rally of the last few months. To be clear, we do expect a bumpy road ahead and, therefore, that risk assets will have to lower their cruising speed. Tensions between China and the U.S., the risk of a second wave of COVID-19, November U.S. elections, and potential second-round effects on economic growth are all reasons to exercise caution in the short term. Nevertheless, when we look at other periods of similar stock market rallies, we see that they tend to precede other periods of positive returns for risk assets—not the other way around. What's more, while markets are certainly not cheap, neither our sentiment indicator nor our measure of stocks' valuations relative to government bonds are indicative of investor exuberance. Overall, we consider that the current investment backdrop justifies a moderately pro-risk positioning, a strategy we stand ready to adjust as the situation evolves.

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%	5.0%	0.0%
Fixed income (duration: 6 years)[1]	60% to 100%	70.0%	67.5%	0.0%
Canadian equities	0% to 30%	8.0%	9.0%	0.0%
U.S. equities		8.0%	10.0%	0.0%
Foreign equities		4.0%	3.5%	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%	0.0%
Fixed income (duration: 6 years)[1]	45% to 80%	55.0%	53.0%	0.0%
Canadian equities	20% to 45%	14.0%	15.0%	0.0%
U.S. equities		14.0%	16.0%	0.0%
Foreign equities		7.0%	6.0%	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%	0.0%
Fixed income (duration: 6 years)[1]	30% to 65%	40.0%	37.5%	0.0%
Canadian equities	30% to 65%	18.0%	19.0%	0.0%
U.S. equities		18.0%	20.5%	0.0%
Foreign equities		9.0%	8.0%	0.0%
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.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 25%	5.0%	5.0%	0.0%
Fixed income (duration: 6 years)[1]	20% to 45%	30.0%	28.0%	0.0%
Canadian equities	40% to 75%	22.0%	23.0%	0.0%
U.S. equities		22.0%	24.0%	0.0%
Foreign equities		11.0%	10.0%	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%	5.0%	0.0%
Fixed income (duration: 6 years)[1]	0% to 30%	15.0%	13.5%	0.0%
Canadian equities	55% to 100%	26.0%	27.0%	0.0%
U.S. equities		26.0%	28.0%	0.0%
Foreign equities		13.0%	11.5%	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

	2018	2019	2020 (Forecast)	2021 (Forecast)
Gross Domestic Product %				
Canada	2.0	1.7	-7.1	4.9
U.S.	2.9	2.3	-6.0	4.7
Inflation %				
Canada	2.3	1.9	0.9	2.0
U.S.	2.4	1.8	1.0	1.8

	June 2020		December 2020		December 2021	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-bills, 91-day)	0.20	0.15	0.20	0.15	0.35	0.30
10-year bond yields	0.80	0.95	0.90	1.15	1.00	1.20
30-year bond yields	1.40	1.75	1.55	1.85	1.60	1.85
Canadian dollar	US $0.73		US $0.74		US $0.76	