

Building your financial future

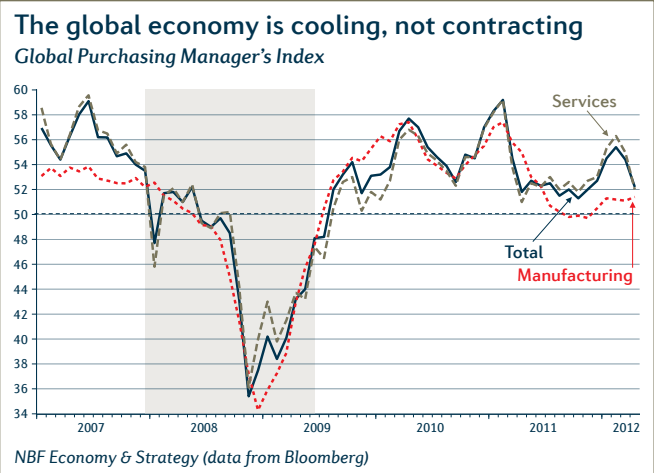
Investment Strategy

June 2012

Global economy

Fear of a financial crisis is spreading once again as the newest wave of risk washes over Europe. Driving the concern is the rising probability of a Greek exit from the euro and a weakening of the European financial system. Many banks in the monetary union, especially those in debt-ridden countries, are struggling to stabilize their balance sheets and keep their capital ratios healthy. Among euro zone governments, there is growing disagreement on how to manage the current debt problems. One thing is certain: the recent French and Greek elections signal that a majority of voters are dissatisfied with the direction and, more importantly, the consequences of the current fiscal reform. In our view, Europe cannot spend its way out of the current crisis. In the near term, we expect monetary policy to play an increasing role in assuaging the difficulties resulting from austerity. That would buy time for politicians to improve national competitiveness and raise long-term potential growth. At this juncture, we note that, recession in Europe notwithstanding, the global economy is still growing.

Global industrial production was up 0.2% in March, a sixth consecutive monthly increase. Importantly, global growth extended into Q2 2012 based on the global PMI index, which remained above the threshold of 50 in May. Though the downside risks to growth have increased in recent months, our baseline scenario still calls for an expansion of global GDP of just above 3% in 2012.



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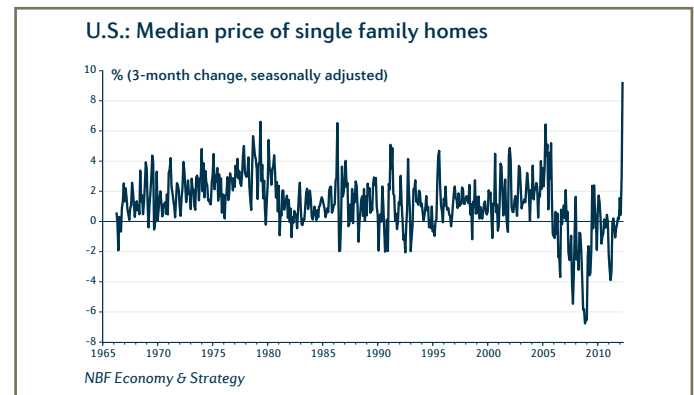
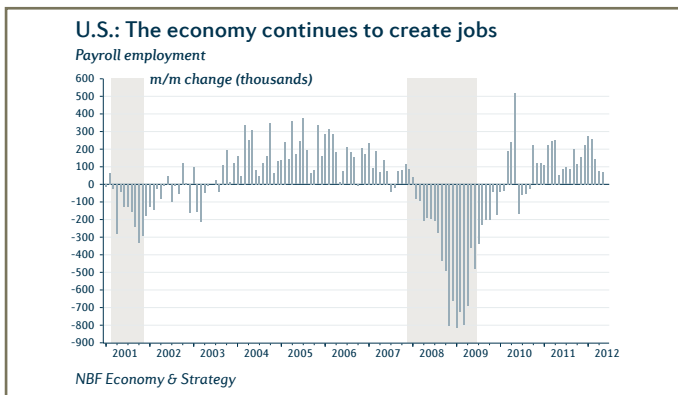
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United States

Recoveries tend to be uneven and the first half of 2012 seems to be a case in point. There are indications that the U.S. economy has hit a soft patch with a deceleration in growth and employment creation. GDP expanded 1.9% in Q1 2012, down from around 3% in the previous quarter. The deceleration appears to have impacted labour markets, with payroll employment showing lacklustre growth of around 70,000 in both April and May (chart).

But there is good news too for the U.S. economy. The housing market seems to have stabilized, with residential construction up in Q1 for a fourth consecutive quarter. That trend seems to have continued in Q2, judging by a further ramp-up in housing starts in April and a rise of the homebuilder confidence index to a five-year high in May. The continued uptrend in job creation is spurring household formation, which propelled the number of occupied housing units to a record high in Q1 2012. As a result, the inventory overhang

of unsold homes is falling and price deflation appears to be a thing of the past. The price of existing single-family homes actually increased 9.2% in the three months through April on a seasonally adjusted basis. That was the biggest increase on record (chart). This development combined with falling gasoline prices and declining mortgage rates should help support consumer spending in the coming months. Under these circumstances, we still expect the current slowdown to be temporary and anticipate a pickup under the auspices of an accommodative Federal Reserve that remains committed to keeping financial markets functional in the face of the ongoing European crisis. Our current baseline scenario calling for economic growth of 2% or more in the next few months also assumes that U.S. politicians will not repeat the same mistakes as last year when it comes to negotiations on fiscal policy. Failure to reach an agreement last summer undermined confidence, provoking a government credit downgrade and a sharp deceleration in economic activity.

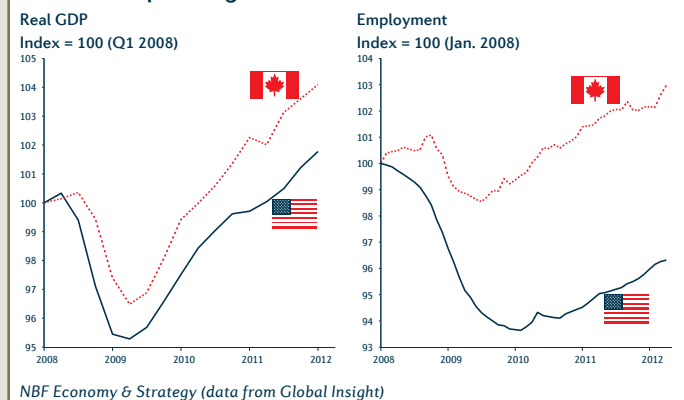


Canada

The Bank of Canada now stands alone among major world central banks in considering tighter monetary policy. The BoC's stance rests on an improving economy which has allowed both Canadian output and employment to recover from the Great Recession and to rise to more than 5% above 2007 levels, in sharp contrast to the performance stateside (chart). The euro zone might be weak but fortunately for Canadian trade, it is the U.S. that matters, not Europe. The continued expansion stateside allowed our export volumes to pick up despite the challenges brought by a strong Canadian dollar. Strong U.S. demand for autos in particular is boosting Canadian exports of autos and parts. There are some concerns from the central bank about household debt accumulation, which it views as "the biggest domestic risk." Thanks to rising homeownership rates, the oft-mentioned debt-to-disposable-income ratio is now at a record 150%. Currently, debt servicing is quite manageable for most households, with mortgage payments as a percentage of disposable income remaining close to the average of the last decade despite home prices soaring over 40% in the last 10 years. Thank record low mortgage rates for that. The risk, of course, is a sudden sharp increase in interest rates. That scenario is highly unlikely in

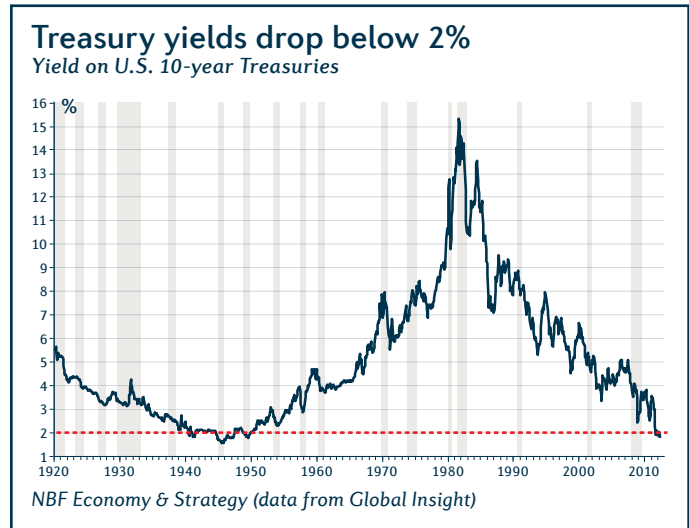
our view. While rates are set to rise, they should do so very gradually and not before next year. There are just too many headwinds from foreign sources at the moment. With GDP expanding at a clip of around 2% currently, there is no rush for the Bank of Canada to change its monetary stance.

Canada: Expanding GDP and labour markets



Financial Markets

Financial markets have been hit in Q2 with a bout of risk aversion that has intensified over the last month. The prospect of a renewed financial crisis in Europe has sent the risk premium on global equities soaring. Several national indexes have fallen into bear-market territory. In Greece and Spain, the losses have been devastating. In North America, the U.S. large-cap indexes have corrected less than their Canadian counterparts. Much of the difference can be attributed to the exposure of Canadian indexes to resource sectors, which are down significantly. Current developments suggest that the balance of risk has moved toward a worse-than-expected recession in Europe and increased stress on the European financial system, implying the possibility of lower-than-expected earnings growth. Though yields on North American government bonds have reached new cyclical lows this quarter, they are unlikely to move back up much in the face of ongoing euro zone uncertainty and falling inflationary pressures.



Riding the Winds of Change to Better Opportunities

In October 2011, central banks around the world did what they deemed and believed was necessary to prevent the emergence of a European banking crisis similar to what unfolded in the U.S. in 2008. However, authorities underestimated to a degree the people's resentment to the austerity measures that were being imposed on them, which transpired in spectacular fashion at the polls as governments in the Netherlands, France and Greece were toppled. Consequently, some of the risks that policy makers set out to mitigate began to materialize and, as of this writing¹, remain skewed to the downside. In this context, the odds of a Greek exit from the euro have risen significantly, while sovereign spreads in Spain and Italy have widened considerably, creating a sense of "déjà vu" that has increased investors' degree of risk aversion. On the markets, this translated into record low yields for those bonds that are considered safe — such as U.S., Canadian and German issues — and lower equity prices. However, the decline in equities was by no means uniform, as some fared better than others, particularly in the U.S., where a portion of the gains of the first quarter were preserved. In Canada, equity markets surrendered all the gains of 2012 and in fact retreated back to late 2011 levels, as commodity prices also corrected significantly. Across the

globe, equity markets in some peripheral European countries were hit hardest, as most entered into bear market territory.

In recent weeks, expectations of further central bank easing have increased; however, history suggests that markets may have to correct even more to force the issue. As such, we believe that in the short term, prudence remains of the essence. Commodity prices are falling fast and global demand is decelerating, which raises the spectre of deflation and fosters an environment of uncertainty. On the other hand, China is in the early stages of easing its policies; the European recession could be deeper than consensus expectations, while the U.S. economy is in the midst of a soft patch.

Although we raised cash levels to an overweighting at the end of March, it was not defensive enough to weather the significant pullback in equities. Market momentum took our equity stance to a slight underweighting over the period, and as the trend is turning more negative, we believe that it is still timely to overweight safe haven securities like government bonds and the U.S. dollar. Bond yields are low but remain in a downtrend and in our opinion continue to offer the best protection, while stocks may decline further and returns on cash are at zero. Across the equity spectrum, we are continuing to favour the U.S. market,

owing to its lower beta, while remaining neutral the commodity-linked Canadian market as well as emerging markets in waiting for more significant action in China and/or a reacceleration in U.S. economic growth. Elsewhere, we are maintaining our underweight in international stocks — where the risk in the short term remains elevated — as well as in equity-correlated assets such as high yield bonds.

With this in mind, we firmly believe that the current situation will in all likelihood create attractive investment opportunities in the long term, but for now we remain convinced that risks are skewed to the downside. Still, should policy makers decide to act in concert, as in 2008, a tactical realignment of positions might become warranted.

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%	12.0%	0.0
Fixed-income (duration: 5.9 years) ¹	60% to 100%	70.0%	70.0%	1.0
Canadian equities		10.0%	9.5%	-0.5
U.S. equities	0% to 30%	5.0%	5.5%	0.0
Foreign equities		5.0%	3.0%	-0.5

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 15%	5.0%	7.0%	0.0
Fixed-income (duration: 5.9 years) ¹	50% to 80%	60.0%	60.0%	2.0
Canadian equities		20.0%	19.5%	-1.0
U.S. equities	20% to 45%	7.5%	8.5%	-0.5
Foreign equities		7.5%	5.0%	-0.5

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.

Cash equivalents	0% to 20%	5.0%	6.5%	0.0
Fixed-income (duration: 5.9 years) ¹	30% to 65%	45.0%	45.0%	2.0
Canadian equities		25.0%	24.0%	-1.0
U.S. equities	30% to 65%	10.0%	11.5%	-0.5
Foreign equities		10.0%	8.0%	-0.5
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.

Cash equivalents	0% to 25%	0.0%	2.0%	0.0
Fixed-income (duration: 5.9 years) ¹	25% to 45%	35.0%	35.0%	1.5
Canadian equities		25.0%	24.5%	-0.5
U.S. equities	40% to 75%	15.0%	17.0%	0.0
Foreign equities		15.0%	11.5%	-1.0
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.

Cash equivalents	0% to 30%	0.0%	1.0%	0.0
Fixed-income (duration: 5.9 years) ¹	0% to 30%	20.0%	20.0%	1.0
Canadian equities		25.0%	24.5%	-0.5
U.S. equities	55% to 100%	20.0%	22.5%	0.0
Foreign equities		20.0%	17.0%	-1.0
Alternative investments ²	0% to 25%	15.0%	15.0%	0.5

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				Rate%	June 2012		December 2012		December 2013	
	2010	2011	2012	2013		Canada	U.S.	Canada	U.S.	Canada	U.S.
Gross Domestic Product%											
Canada	3.2	2.4	1.9	2.0	Short-term rates (T-Bills, 91-Day)	0.96	0.08	0.96	0.08	1.93	0.16
U.S.	3.0	1.7	2.0	2.1	10-year bond yields	1.81	1.66	2.06	1.96	2.87	2.60
Inflation%					30-year bond yields	2.38	2.77	2.54	2.94	3.23	3.50
Canada	1.8	2.9	1.8	2.0	Canadian dollar	U.S.\$1.00		U.S.\$0.98		U.S.\$1.00	
U.S.	1.6	3.1	1.7	1.3							

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