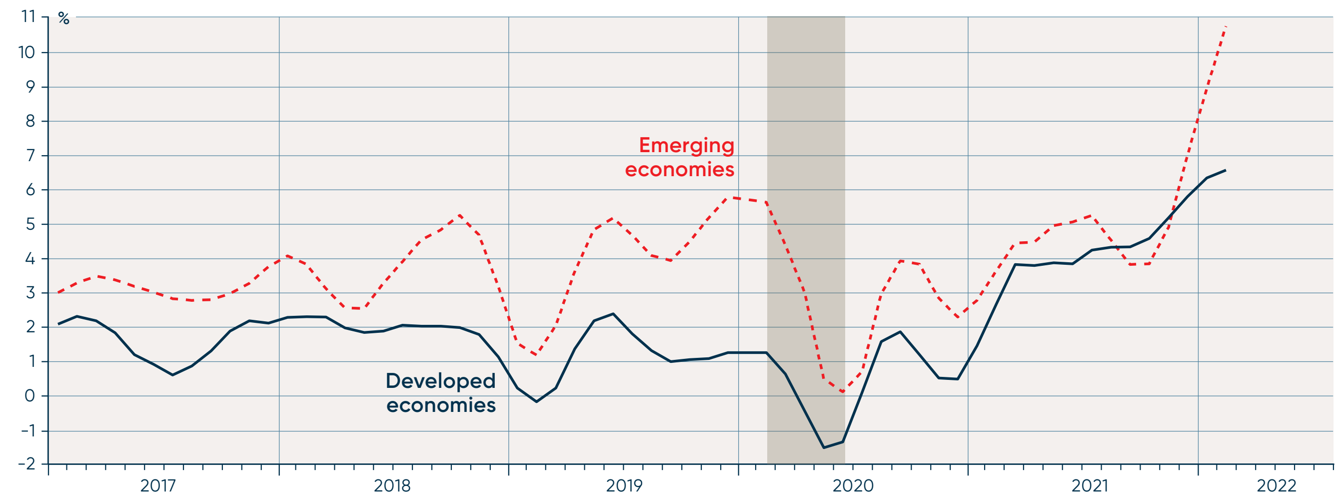
June 2022
Building your financial future

Investment Strategy

World

While the pandemic appears to be in retreat, the economic cycle remains tied to a hostile geopolitical environment ever since Russia invaded Ukraine. From a financial standpoint, the conflict has exacerbated what was already a clear trend reversal for risky assets, with equity markets suffering significant losses in the first few months of the year and widening credit spreads increasing the cost of capital for companies. In the real economy, consumers and businesses around the world have been affected by rising raw material and commodity prices. The shock has been particularly striking in Europe, where a significant portion of electric power is generated using natural gas, the price of which has surged. But the conflict in Ukraine has had repercussions far beyond the borders of the old continent. Sharply higher food and energy prices have also had negative impacts in emerging countries, where several central banks—especially those in energy-importing countries—have had to substantially tighten their monetary policies. The hikes in interest rates, combined with the recent increase in government borrowing and an appreciation of the U.S. dollar, have also increased the cost of servicing debt. Moreover, the global supply chain continues to suffer from China's zero-COVID policy. The easing of restrictions in the world's second largest economy was welcomed by investors as it could allow global trade flows to start recovering as Chinese factories reopen. Given this environment, over the last three months we have revised our global growth forecast for 2022 downward, from 4.0% to 3.0%.

World: Inflation soars in emerging markets
All-items CPI, annualized 3-month change



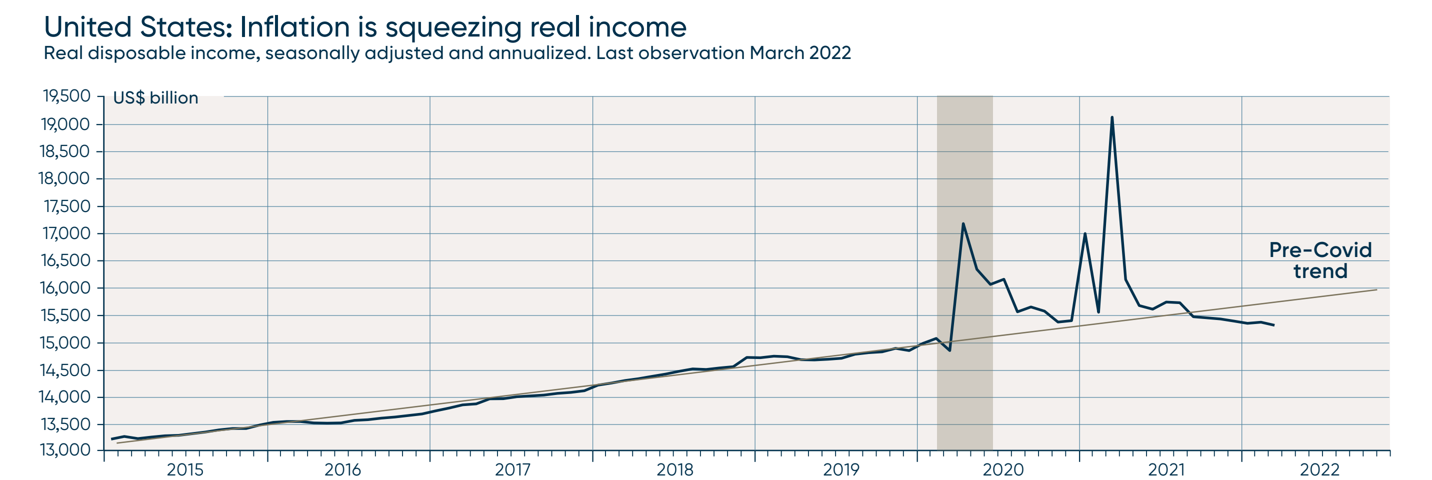
NBF Economics and Strategy (IMF data)

In this issue

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

United States

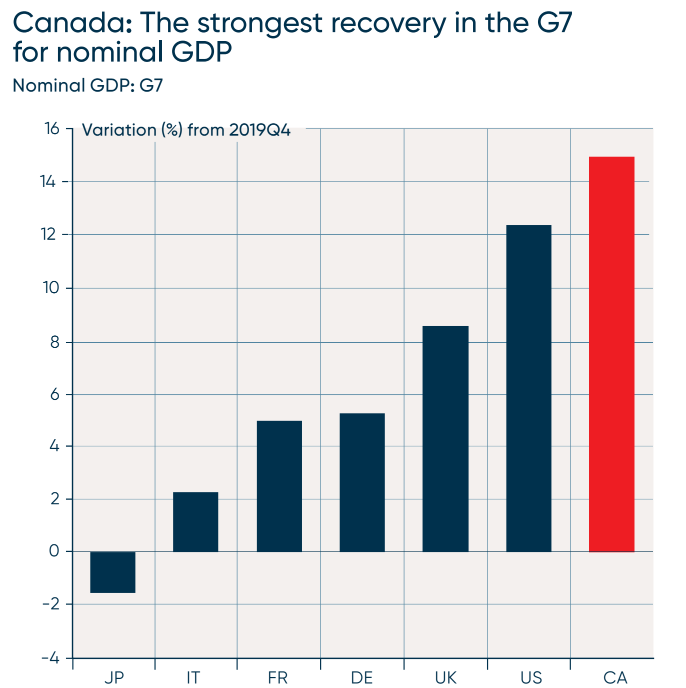
Compared to other regions in the world, the United States was relatively well positioned to deal with the current challenges. While it is true that the world's largest economy contracted in the first quarter of 2022, this was not cause for much concern, since the drop was largely due to a sharp increase in imports. Domestic demand, which is more representative of the economy, continued to grow. After a rather slow recovery early in the pandemic, the labour market has gone from strength to strength, such that many businesses were forced to implement substantial increases in compensation. Implemented in an environment where inflation was already running high, these increases prompted the Federal Reserve to raise policy rates for the first time since 2019 and announce more rate hikes this year. This tightening of monetary policy should slow the pace of the U.S. economy in the coming months. The housing market is already showing signs of a significant slowdown after the frenzy of the past two years and the ISM manufacturing report is flagging a moderation in employment growth. The Fed's Beige book, for its part, reported «hiring freezes» in some regions that may reflect deteriorating operating conditions for U.S. businesses. Although households are still well positioned, and should be able to support consumption with some of their excess savings accumulated during the crisis, it remains that real incomes are in a downward trend for several months as inflation is running higher than expected. We expect U.S. GDP to grow 2.4% in 2022 and 1.5% in 2023.



NBF Economics and Strategy (Bloomberg data)

Canada

While the U.S. economy contracted in the first quarter, Canada posted a third consecutive quarter of solid growth (3.1% annualized) despite the health measures that hit in January. Domestic demand grew by nearly 5% for a second consecutive quarter, illustrating the strength of the domestic economy. Inflation is higher than expected and the unemployment rate is at a record low, so the central bank can be expected to continue normalizing interest rates at an accelerating pace. Like other global economies, the Canadian economy could be affected by the inflationary pressures resulting from the war in Europe and lockdowns in China, but it remains in a relatively good position. Consumers have surplus savings, which should help them to absorb the shock, and the labour market, which is enjoying full employment, support wage growth. In the first quarter of 2022, workers' compensation increased by 16% annualized, the largest quarterly increase since 1981 excluding the third quarter of 2020. Record high commodity prices for Canadian producers could encourage investment. As for governments, there is no sign of a period of austerity in light of recent federal and provincial budgets, with soaring nominal GDP boosting government revenues. Our growth forecast is 3,5% in 2022 and we expect growth to moderate to 1,5% in 2023.



NBF Economics and Strategy (data via Refinitiv)

Investment Strategy

The second quarter was particularly challenging for markets. With inflation still running high, North American central banks turned even more hawkish as they now consider moving monetary policy into restrictive territory. Market angst was compounded by the ongoing conflict in Ukraine and the marked slowdown in the Chinese economy caused by strict containment measures. In the face of this unfavourable environment, investors' risk appetite weakened significantly during the quarter. While Canadian equities high exposure to the resources sector has kept its losses limited relative to its peers, U.S. stocks entered bear market territory in June, a phenomenon typically observed in times of recession. For their part, bonds – which are inherently less risky than equities – were not spared, as soaring interest rates led to unusually high losses in this asset class.

For several months now, the tough battle between central banks and inflation has been shaking financial markets, and there is good reason to believe that this duel will continue over the coming quarter. With annual price growth refusing to abate and a potentially overheated labour market, monetary policy makers have a monumental task ahead of them: slowing the economy so that inflation subsides without causing a recession. This «soft landing» will not be easy to orchestrate, especially since many factors are simply beyond the control of central banks. For example, the Chinese authorities' zero-COVID approach poses a threat to global growth as well as to the normalization of supply chains, while the Ukrainian conflict continues to have a major impact on oil and food prices.

Nevertheless, while the environment has undeniably become more challenging, several indicators continue to suggest we will ultimately avoid a more adverse economic scenario. First, key measures of underlying growth remain robust in the United States, with household finances supported by stronger wages and a large pool of savings accumulated during the pandemic. In addition, the rebalancing of demand between goods and services as well as the monetary tightening already in effect in financial markets should ultimately weigh on inflationary pressures in the second half of the year. Finally, leading indicators, such as the shape of the yield curve, also suggest that current recession fears are somewhat premature, although this could change quickly should the Federal Reserve push its policy rate into restrictive territory expeditiously.

Overall, the precariousness of the current economic environment necessarily suggests more uncertainty in our outlook, and the next quarter promises to remain highly volatile as a result. To be clear, equity markets appear to have already discounted a significant economic slowdown such that investors with a longer-term horizon are well advised to ignore these fluctuations and stay the course, as history has shown repeatedly in such conditions in the past. That said, a sustained move higher will likely require central banks to temper their rate hike expectations, and the timing of that remains highly uncertain. Meanwhile, bonds' relentless decline has translated into much more attractive risk-reward properties for the asset class on a forward basis.

Under these conditions, we have reduced equities' weight closer to neutral levels in favour of both bonds and cash in our tactical asset allocation. Geographically, we continue to favour Canadian equities, which trade at especially attractive valuations levels despite outperforming their peers in 2022. In the U.S., the S&P 500 higher growth exposure makes it more sensible to inflation and interest rates dynamics, which inclined us to reduce their allocation in line with our reference index. In emerging markets, the situation remains precarious, but China's increasingly accommodative policies could see the worlds' second-biggest economy pick-up from its lows in the second part of the year. Finally, we remain less optimistic for the EAFE region where recession risks are much more material.

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%	6.5%	0.0%
Fixed income (duration: 5.50 years)[1]	60% to 100%	70.0%	68.0%	4.5%
Canadian equities	0% to 30%	8.0%	9.00%	-2.25%
U.S. equities		8.0%	8.50%	-2.25%
Foreign equities		4.0%	3.0%	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%	6.5%	0.0%
Fixed income (duration: 5.50 years)[1]	45% to 80%	55.0%	53.0%	4.5%
Canadian equities	20% to 45%	14.0%	15.5%	-2.0%
U.S. equities		14.0%	14.5%	-2.5%
Foreign equities		7.0%	5.5%	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%	6.0%	0.0%
Fixed income (duration: 5.50 years)[1]	30% to 65%	40.0%	38.5%	4.5%
Canadian equities	30% to 65%	18.0%	19.5%	-2.5%
U.S. equities		18.0%	18.5%	-2.5%
Foreign equities		9.0%	7.5%	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%	6.0%	0.0%
Fixed income (duration: 5.50 years)[1]	20% to 45%	30.0%	28.5%	4.5%
Canadian equities	40% to 75%	22.0%	23.5%	-2.5%
U.S. equities		22.0%	22.5%	-2.5%
Foreign equities		11.0%	9.5%	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.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 30%	5.0%	6.0%	0.0%
Fixed income (duration: 5.50 years)[1]	0% to 30%	15.0%	13.5%	4.5%
Canadian equities	55% to 100%	26.0%	27.5%	-2.5%
U.S. equities		26.0%	26.5%	-2.5%
Foreign equities		13.0%	11.5%	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

	2020	2021	2022 (Forecast)	2023 (Forecast)
Gross Domestic Product %				
Canada	-5.2	4.5	3.5	1.5
U.S.	-3.4	5.7	2.4	1.5
Inflation %				
Canada	0.7	3.4	6.2	2.2
U.S.	1.3	4.7	8.2	2.9

	June 2022		December 2022		December 2023	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-bills, 91-day)	1.97	1.69	3.25	2.90	3.20	2.85
10-year bond yields	3.46	3.33	3.60	3.30	3.30	2.95
30-year bond yields	3.33	3.39	3.55	3.40	3.35	3.10
Canadian Dollar	US $0.78		US $0.82		US $0.79	