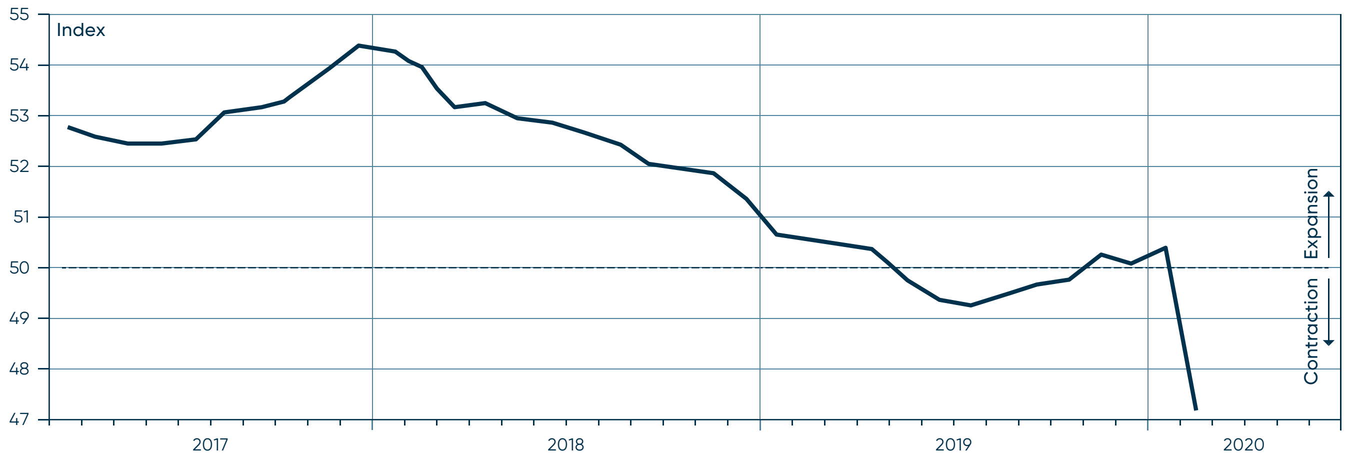
March 2020
Building your financial future

Investment Strategy

World

The persistence of virus-related production shutdowns and resulting supply chain shocks across the world suggest global economic growth will be weak in the first quarter of the year. While goods production will bounce back later in the year, lost output in service-producing sectors including travel and tourism won't be fully recouped. We have, accordingly, revised our growth forecast for the world economy to show the weakest growth since 2009. Encouragingly, policymakers the world over are responding to the challenge. Central banks have moved quickly to give economies a shot in the arm by cutting policy rates. Governments have pledged to help with fiscal stimulus in the coming months. In China, economic activity is resuming as the number of new confirmed cases of COVID-19 is trending down and more people are recovering from the virus than becoming sick with it. We expect global economic activity to start normalizing during the second half of the year.

World: Factory conditions deteriorate
Markit Manufacturing PMI. Last observation: February 2020



NBF Economics and Strategy (Source: Markit via Refinitiv)

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

In this issue

United States

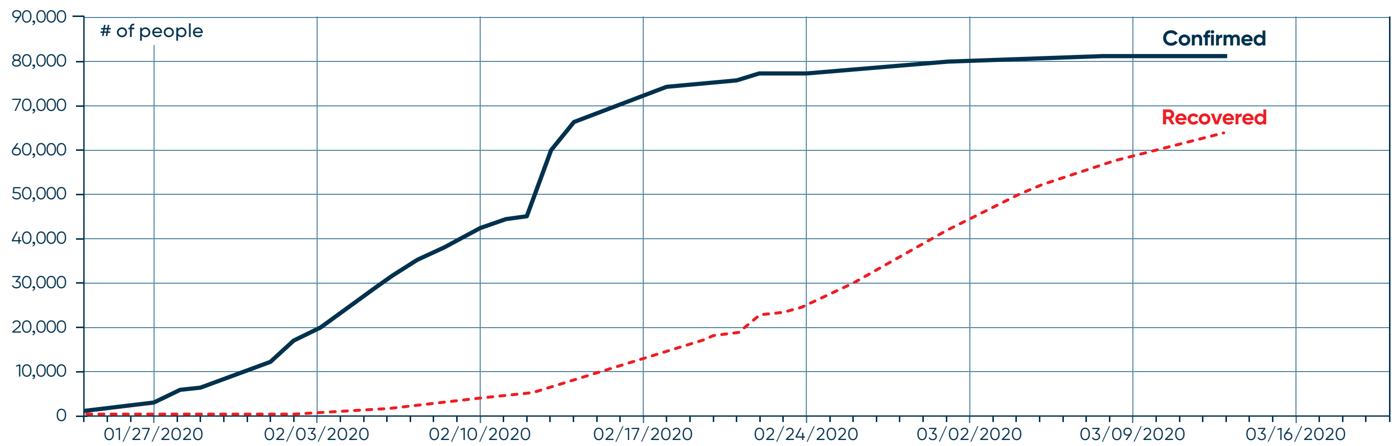
While households are making the best of low borrowing rates, America's businesses seem to be more cautious. Commercial and industrial loans are indeed on track to fall for the second consecutive quarter. Souring business optimism is even more apparent when looking at investment and job openings, which are contracting synchronously for the first time since the Great Recession of 2008-09. As such, caution is warranted about U.S. economic prospects in the coming quarters, more so considering the threats to economic activity presented by COVID-19. We see the Federal Reserve lowering interest rates aggressively in the coming weeks as well as providing ample liquidity to financial markets.

Canada

After hurting economic activity in Q4 last year, disruptions to the rail network now threaten to blunt the expected rebound of Canadian GDP in the first quarter of 2020. The COVID-19 outbreak has potential to hurt output not only in the service sector but also in manufacturing as global supply chains get disrupted by virus-related shutdowns of factories in China. We have cut our forecast for 2020 Canadian GDP growth by three ticks to 1.5%. Given the deteriorating outlook, we expect the Bank of Canada to again lower its overnight rate in the coming weeks and for Ottawa to deploy fiscal stimulus to support the economy.

China: The number of new confirmed cases is trending down

Cumulative sum of confirmed and recovered cases of COVID-19 in China



NBF Economics and Strategy (data via https://systems.jhu.edu/research/public-health/ncov as of March 13, 2020)

Investment Strategy

After a good start to the year for most risk assets – buoyed by the signing of an interim agreement between China and the United States and a rebound in key economic indicators – global markets were caught off guard late in February as we learned that COVID-19 was spreading rapidly around the world. The days that followed saw equities exhibit exceptionally high levels of volatility as most stock indices entered bear market territory – marked as a decline of 20% or more – at an unprecedented speed. Adding fuel to fire, oil prices saw their levels fall to levels not seen since the early 2000s following the breakdown of negotiations between OPEC member countries (+Russia) prompting Saudi Arabia to engage in a price war. Meanwhile, the race into safe havens together with extraordinary measures taken by most central banks pushed government bond yields to historic new lows. Quite a quarter.

Now, what to think of such variations? Simply put, markets are currently traversing a storm in the form of a pandemic, doing their best to push forward — albeit with much reduced visibility on the near-term trajectory of the economy. As such, we should continue to see gusts in all directions as markets continually recalibrate their expectations in light of available information. One thing is certain, however. Economic disruptions resulting from the extraordinary efforts put in place to contain the COVID-19 contagion implies that the question is no longer "if" or "when" global growth will decline, but by how much and for how long.

Despite all of this, while we were quick to bring our own risk exposure down to neutral early in the crisis by lowering the equity weight and moderately raising cash in most of our investment solutions, we have been reluctant all along to take a more defensive stance. First, the rapidity and magnitude of the downturn suggests that a serious economic shock is now priced in. Second, our market sentiment indicator has recently reached levels that have often preceded sharp reversals in stock prices. Third, coordinated efforts from central banks and governments around the globe should allow financial markets, businesses, and households to weather this ordeal without fatal economic accidents. And finally, the Asian experience with COVID-19 shows that quarantine measures are effective at combatting the spread of the virus given that authorities act quickly and decisively. Europe and the U.S.A. may have been slow to react, but now that governments and a majority of people are taking the threat seriously, the speed of contagion is most likely set to fall.

Within equities, we continue to expect U.S. stocks to fare relatively better than their peers this year. Much uncertainty remains and their market is in no way immune from a pandemic-led global slowdown, but the country still compares advantageously to the rest of the world in terms of economic momentum. Turning to Europe, Australasia and the Far East (EAFE), we maintain an underweight positioning. Japan was already vulnerable before the Coronavirus crisis showed up, its economy having already shrunk in Q4-2019 following a rise in consumption tax last autumn. As for Europe, the latest data still showed some growth, but its relative economic fragility, dependence on global trade and tourism, and lack of monetary munitions don't bode well in the near-term.

In conclusion, a period as extreme as the one we experienced in the first quarter requires some hindsight. Though painful at times, it should not be forgotten that it is in the very nature of stock markets to experience bouts of heightened volatility and fear. Now, the worst may be behind us, but the reality is that markets are likely to remain nervous over the coming months as new data reveals the very real economic impact of the pandemic. Nevertheless, another reality is that recent market movements have pushed the equity risk premium – a measure of stocks' expected return relative to safer government bonds – at an 8-year high, a promising sign for investors whose investment horizon is measured in years rather than months.

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