

Investment Strategy

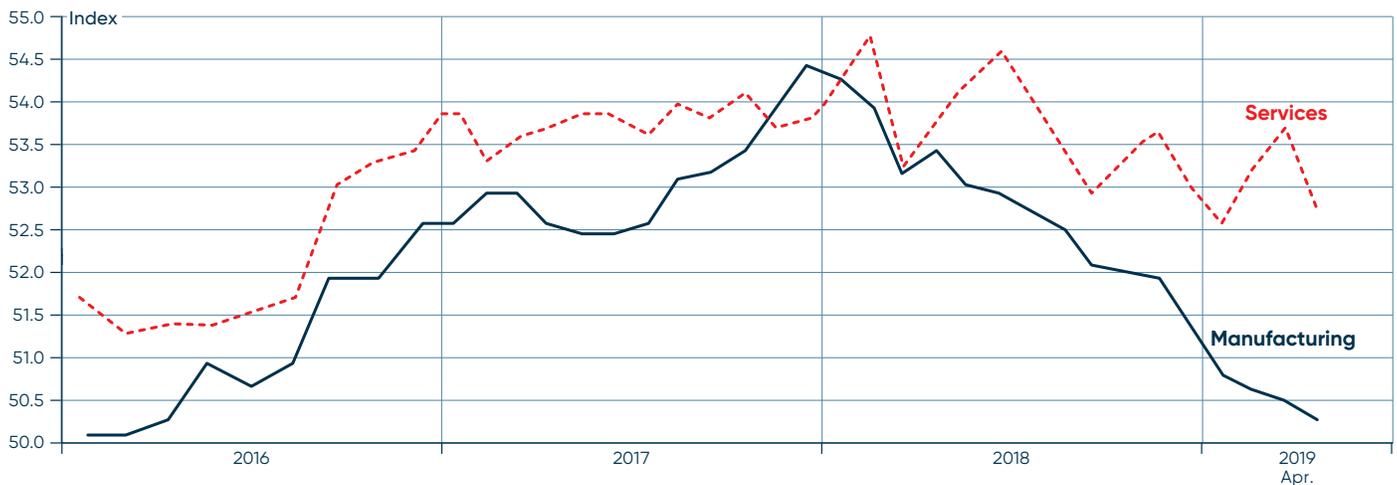
World

A fragile global economy was dealt another blow in May, thanks to a one-two punch from the U.S. and China, which jacked up tariffs on imports from each other, so much so that the U.S. now has 25% tariffs on roughly half of its goods imports from China, while the latter has 25% tariffs on almost all goods imports from the U.S. The ramp-up in trade barriers is bad news for the global economy, with an already-weakened manufacturing sector likely

to suffer the most from the slowdown in trade. While the services sector is showing resilience for now, this could change if the factory slump generates negative spillovers, e.g., job losses that lead to broader weakness in disposable incomes. If tariffs persist or, worse, are increased further, world trade volumes will struggle to gain traction, putting in jeopardy our 2019 GDP growth forecast of 3.3% for the world economy.

World: Factory activity weakest since 2016

Global purchasing managers' indices in the manufacturing and services sectors



NBF Economics and Strategy (data via Markit)

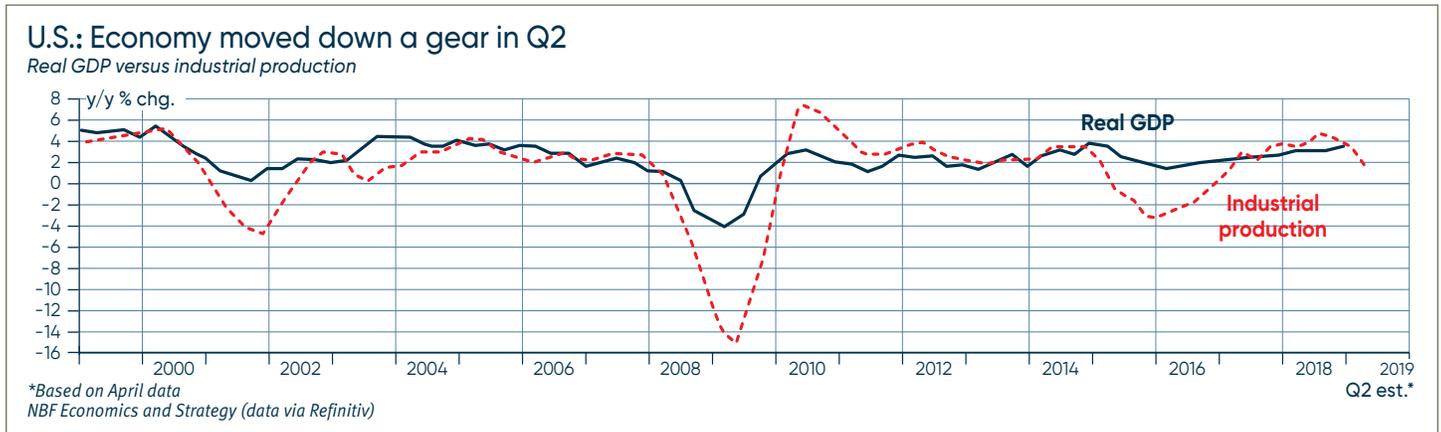
In this issue

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

United States

While there's not enough data at this point to say for sure, we're expecting Q2 growth to soften to around 1.5%, hurt in part by weak business investment. That said, consumption spending, which accounts for roughly two-thirds of U.S. GDP, is well on track to bounce back after a disappointing first quarter. The outlook for the second half of 2019 is harder to read, more so after the U.S. escalated its trade war with China. Indeed, trade-related uncertainties, if they persist, could pull back business investment and derail growth. With the assumption that negotiators come

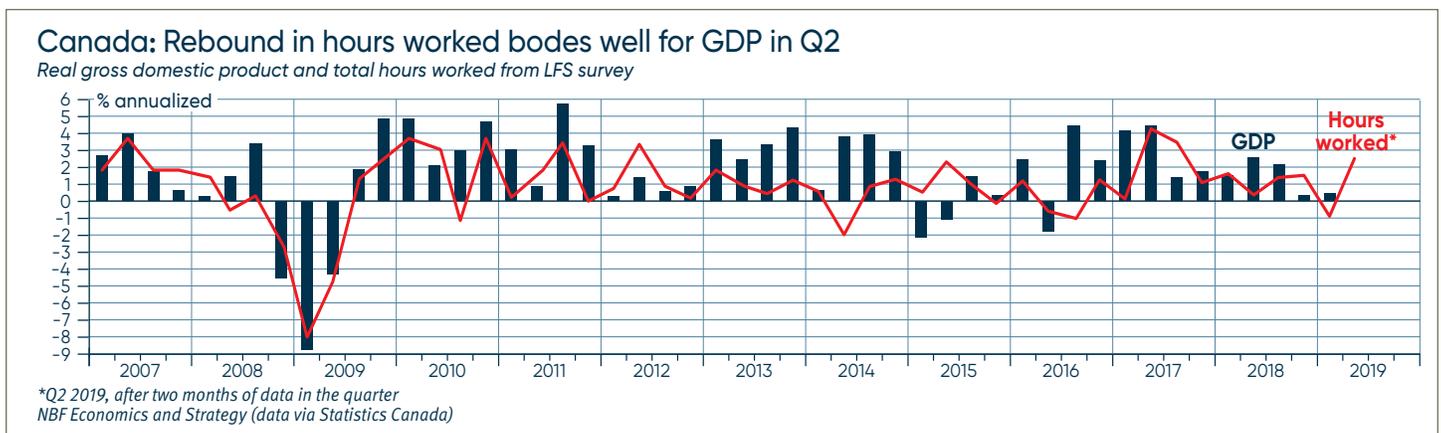
to their senses and step back from their dangerous stance, we are keeping our 2019 growth call of 2.5% unchanged. Tariffs, which were meant to reduce the massive U.S. trade deficit, haven't had the desired impacts. While the trade deficit with China is falling (in large part due to tariffs), that's being offset by rising deficits with the rest of the world. This is what the IMF called "trade-diversion effects" in last April's World Economic Outlook, when it predicted the overall U.S. trade balance would not improve all that much, despite tariffs.



Canada

The Canadian economy started 2019 with soft GDP growth: 0.4% annualized. Trade was a major drag on Q1 growth, as imports increased and exports faltered. Domestic demand, however, helped support growth, courtesy of contributions from consumption, government spending and business investment, which more than offset yet another drag from residential investment. Could growth accelerate in the second quarter? There is reason to be optimistic. After the recent elimination of U.S. tariffs on Canadian steel and aluminum, exports are set to accelerate. Also supporting our view of accelerating growth is the signal from a crucial coincident indicator, namely

employment. Through the first five months of 2019, job creation in Canada shows a massive gain of 250,000, the best performance since 2002, with 77% of jobs being full-time and 76% coming from the private sector. Importantly, hours worked are up 2.6% annualized so far in Q2, the fastest increase in almost two years. This development supports our view that GDP will expand 2.5% in Q2, i.e., well above the Bank of Canada's estimate of 1.3%. While trade disputes remain a concern, a record-low unemployment rate and accelerating wage inflation do not suggest that an interest rate cut is needed in Canada at this point.



Investment Strategy

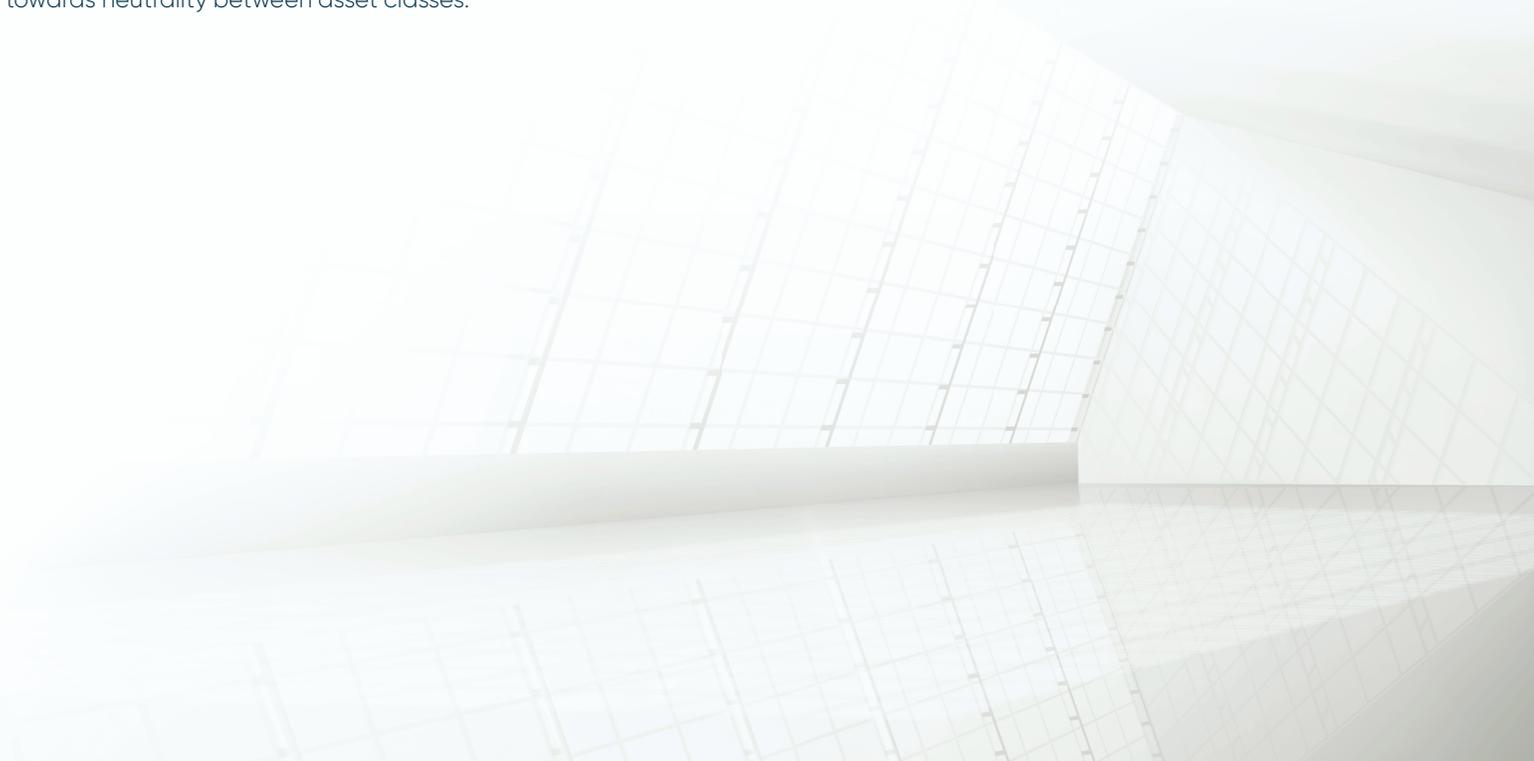
After a flying start to 2019, global risk assets seesawed in the second quarter, contained by the escalation of the trade dispute, which has had the world's two leading economies opposed for over a year now. Overreacting to alarming headlines and geopolitical events is a common mistake made by investors, as it often involves selling and missing the rebound, but that doesn't mean that they should be outright ignored. Typically, such events end up only temporarily affecting investor sentiment without materially impacting the economy. But in the case of the ongoing trade spat, it must be recognized that the effects appear increasingly tangible.

Indeed, institutions such as the New York Fed and the International Monetary Fund have raised some flags lately, quantifying the very concrete impact they expect tariffs to have on consumers and businesses. The bond market also started sending warning signals in recent months, essentially reflecting that it expects the U.S. Federal Reserve to get off the sidelines and start cutting rates in order to sustain the ongoing economic expansion. None of these developments are heralding a recession right around the corner, but they do add to an already-fragile backdrop, especially this late in the business cycle.

Under these circumstances, we downsized our equities position in favour of bonds in May, thereby reducing the overall risk from our asset allocation for a second time this year. To be clear, our base case—with no recession in the cards, monetary policies far from restrictive and decent valuations—continues to call for equities to outperform over the next 12 months. Besides, the vast majority of global economic figures and corporate earnings data released throughout the last quarter continue to depict healthy fundamentals. Rather, it is the increasing probability of a sustained trade conflict in the context of a late-cycle global economy, in addition to the asymmetry of outcomes should our bearish scenario materialize, that justifies our tactical shift towards neutrality between asset classes.

Events of the last few months have also led us to introduce some changes to our geographical equity allocation, stepping up our allocation in North American equities, further downgrading EAFE assets and reducing emerging markets to neutral. For Canada, our overweight positioning worked well since its initiation in early February, as the S&P/TSX Index outperformed all three other main regions over the period. Back then, we argued that its lower volatility and lower valuations made it an attractive alternative in the current tense context, and that still holds true. For their part, U.S. equities are far from immune to trade tensions and are likely to remain quite volatile, but their lowered valuations, resilient economy and flexible central bank tipped the scales in their favour. In contrast, growth in the EAFE region, which is highly dependent on global trade, has slowed down even further while monetary authorities remain stuck, with little room to manoeuvre. For emerging markets, we shall not underestimate China's capacity to promptly inject stimulus should trade tensions further threaten their economy, but sustained leadership is unlikely for as long as the conflict holds.

In short, the investment environment got blurry in Q2, due to the resurgence of the U.S./China trade conflict. That does not mean that the fundamentals have really deteriorated, but it naturally reduces our visibility on their trajectory going forward. As such, a prudent approach to investing is warranted until we get more clarity over the true state of things, which is likely to happen over the next quarter.



Income Portfolio	Asset Class	Minimum/Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
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.	Cash equivalents	0% to 20%	5.0%	5.0%	-1.0%
	Fixed income (duration: 6.2 years) ¹	60% to 100%	70.0%	69.0%	3.0%
	Canadian equities	0% to 30%	8.0%	9.0%	0.0%
	U.S. equities		8.0%	9.0%	0.0%
	Foreign equities		4.0%	3.0%	-2.0%
	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.	Cash equivalents	0% to 20%	5.0%	5.0%	0.0%
	Fixed income (duration: 6.2 years) ¹	45% to 80%	55.0%	54.0%	3.0%
	Canadian equities	20% to 45%	14.0%	15.5%	0.0%
	U.S. equities		14.0%	15.5%	0.0%
	Foreign equities		7.0%	5.0%	-3.0%
	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.	Cash equivalents	0% to 20%	5.0%	5.0%	0.0%
	Fixed income (duration: 6.2 years) ¹	30% to 65%	40.0%	38.0%	3.0%
	Canadian equities	30% to 65%	18.0%	20.0%	0.0%
	U.S. equities		18.0%	20.0%	0.0%
	Foreign equities		9.0%	7.0%	-3.0%
	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.	Cash equivalents	0% to 25%	5.0%	5.0%	0.0%
	Fixed income (duration: 6.2 years) ¹	20% to 45%	30.0%	29.0%	3.0%
	Canadian equities	40% to 75%	22.0%	23.5%	0.0%
	U.S. equities		22.0%	23.5%	0.5%
	Foreign equities		11.0%	9.0%	-3.5%
	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.	Cash equivalents	0% to 30%	5.0%	5.0%	0.0%
	Fixed income (duration: 6.2 years) ¹	0% to 30%	15.0%	14.0%	3.0%
	Canadian equities	55% to 100%	26.0%	27.5%	0.0%
	U.S. equities		26.0%	27.5%	0.5%
	Foreign equities		13.0%	11.0%	-3.5%
	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			
	2017	2018	2019	2020
Gross Domestic Product %				
Canada	3.0	1.9	1.4	1.8
U.S.	2.2	2.9	2.5	1.9
Inflation %				
Canada	1.6	2.3	2.0	1.9
U.S.	2.1	2.4	1.8	2.0

	June 2019		December 2019		December 2020	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-Bills, 91-Day)	1.68	2.35	1.68	2.33	2.21	2.77
10-year bond yields	1.60	2.28	2.01	2.80	2.47	3.01
30-year bond yields	1.87	2.69	2.23	3.13	2.65	3.28
Canadian dollar	US \$0.74		US \$0.77		US \$0.75	

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