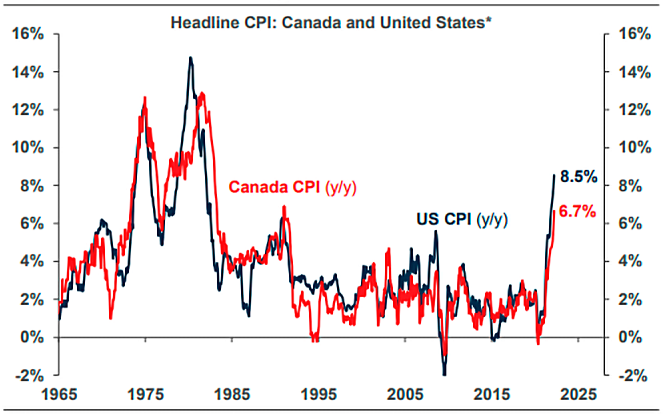
Market Sentiment ~ Laurel Hickey & Garth Bluekens

Comments from the CIO's office

Martin Lefebvre is National Bank Investments Chief Investment Officer and Strategist. Please see below for key takeaways from his May Asset Allocation update.

For now, the economic situation is more akin to overheating than anything else. While the latest U.S. GDP figures showed a slight contraction in the first quarter, this was mainly the result of a sharp increase in imports, while domestic demand remained strong. Thus, after almost two years of a pandemic in which monetary and fiscal authorities preferred to risk overstimulating than the inverse, they are now faced with a red-hot labour market. These circumstances, coupled with severe supply-side disruptions, have pushed inflation to levels not seen in several decades (chat below).

7 | A multi-decade high for inflation...



CIO Office (data via Refinitiv). Note that Statistics Canada doesn't include the price of used cars in CPI, explaining most of the current gap between Canada and the United States.

Now, while major central banks spent most of 2021 counting on the "transitory" nature of inflation, they are now showing much more combative attitudes toward rising prices. Why the change of heart? In short, monetary policy has little impact on the so-called "flexible" components of inflation (e.g., used car prices), and it is these elements which were primarily behind the Consumer Price Index (CPI) rise in the Spring of 2021. This remains the case today, unlike the 1970s when inflation problems were much more chronic. But, in recent months, so-called "persistent" inflation (e.g., shelter costs), which is much more sensitive to monetary policy, has also started to accelerate rapidly.

Looking ahead, all indications are that upward pressure on flexible inflation should finally begin to ease. Despite the war in Ukraine and lockdowns in China, most key input price indices such as shipping costs and global commodities are still showing signs of stabilization.

On the other hand, the unprecedented strength of the labour market and the resulting pressure on wages are likely to continue to lead to price increases for the more persistent components of the consumer basket – primarily services – in the coming months. What will be the combined effect of all these dynamics on headline CPI? It's impossible to predict with any degree of precision. However, base effects imply that year-over-year price growth is very likely to slow down during the quarter, even if the frantic pace of the last 6 months were to continue. And, beyond the simple arithmetic effects, a scenario close to one standard deviation above the historical average appears to be most likely at this stage.

What's Market Sentiment Got To Do With It?

At the time of writing this update in late-May market sentiment indicators are reaching very pessimistic territory. Market sentiment can be defined as the overall attitude of the market. Unlike fundamental explanations for market movement, market sentiment looks at investor psychology and how this impacts the direction stocks move.[1] For example, rising interest rates are more fundamental because with higher interest rates, money in the future has lower value, causing stocks prices to fall. When it comes to investing in a company, even with quantitative

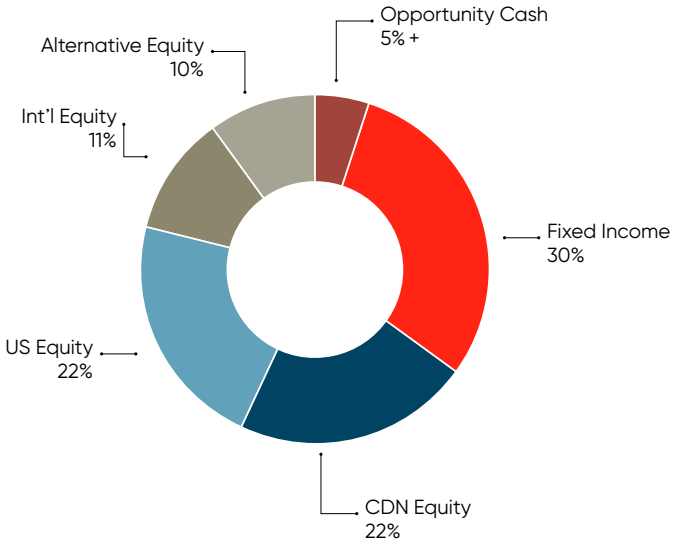
1 Market Sentiment Definition (investopedia.com)

analysis and high-level valuation, someone must make the decision to buy or sell a stock. Even the most rational of investors get nervous or unsure of the outlook of the market. The US stock market is down close to 20% year to date. After close to half of year of seeing declining prices, it is only natural that investors are pessimistic and getting nervous to when the decline will end.

It can be unsettling to hear, but sometimes extreme pessimism can be a signal that we are nearing a market bottom. One market sentiment indicator is the CBOE Volatility Index (VIX). The VIX looks at market volatility when it comes to institutional trading. If more institutions are looking to sell, this leads to VIX being higher. Since institutional trading occurs at larger volumes, there is a larger impact on market movement.[2] The VIX is currently around 30, which is higher when compared to the end of 2021 when it was around 19. To put this in perspective, in March 2020 and at the beginning of the 2008 crash, the VIX was at as high of around 80.[3] We can't predict when the recent market downturn will reverse, and we may not be at a market bottom yet, but we want you to feel comfortable about having your money invested during these volatile times. A market downturn can show your true risk tolerance. If you feel that your risk tolerance is changing, please reach out to us so that we can discuss this with you.

2 The Volatility Index: Reading Market Sentiment (investopedia.com)
3 CBOE Volatility Index (^VIX) Historical Data - Yahoo Finance

Growth Investment Model Goal Asset Allocation



Your Investment Policy

GROWTH PROFILE: Your main goal is to achieve growth in your investments. Although you can tolerate greater changes in the market value in order to increase the value of your assets, you are not prepared to invest your entire portfolio in equities. If you feel that your risk tolerance is shifting, please let us know!

Source: This information is for illustration purposes and subject to change. Your portfolio may not hold all of these positions. We enhance the composition of your portfolio with additional equity solutions that are not illustrated. The weightings change with market fluctuations and model rebalancing.

Laurel Marie Hickey CFP® CIM® FCSI®
Wealth Advisor & Portfolio Manager
239 8th Avenue SW Calgary Alberta T2P 1B9

Garth Bluekens CPA CA PFP® CIM®
Senior Wealth Advisor & Portfolio Manager
404 6th Street S Lethbridge Alberta T1J 2C9

Tel.: 403-531-8429 | **Toll Free:** 1-877-506-7900 | **Email:** laurel.hickey@nbc.ca