Unified

Q2 2022 Review

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

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Outlook for Q3 2022

The second quarter was particularly challenging for markets. 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 natural resources sector helped limit losses, U.S. stocks entered bear market territory in June, a phenomenon typically observed in times of recession. Meanwhile, bonds were not spared either, 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. 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, 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 energy 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 eventually ease inflationary pressures in the second half of the year. Finally, leading indicators, such as the shape of the yield curve, also suggest that a recession is not an inevitable outcome, although that could change quickly if the Federal Reserve does not lower its rate hike intentions by year-end.

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. That said, a sustained recovery will likely require central banks to revise their rate hike forecasts downwards, and the timing of that remains highly uncertain. Meanwhile, the decline in bond prices has translated into much more attractive risk-reward properties for the asset class on a forward basis. Under these circumstances, we have reduced equities to neutral, thereby increasing the weight of bonds and cash within our tactical allocation. Geographically, we continue to favour Canadian equities, which trade at particularly attractive valuation levels. South of the border, the S&P 500's higher exposure to growth makes the index more sensitive to inflation and interest rate dynamics, which has prompted us to reduce the weight of U.S. stocks in line with our benchmark. Finally, we remain less optimistic about the EAFE region, where the risks of recession are much more material.

Quarterly Highlights

Asset classes	June	Q2	YTD
Cash (S&P Canada T-bill)	**0.1%**	**0.3%**	**0.2%**
Bonds (BofA CA Universe)	**-2.1%**	**-5.5%**	**-11.9%**
BofA CA Federal	-1.7%	-4.1%	-9.3%
BofA CA Corporate	-1.5%	-4.7%	-10.9%
BofA CA BBB	-1.5%	-4.8%	-11.3%
Canadian Preferred Shares	-5.3%	-7.5%	-9.9%
BofA US High Yield ($US)	-6.8%	-10.0%	-14.0%
World Equities (MSCI ACWI US	**-8.4%**	**-15.5%**	**-20.0%**
S&P/TSX	-8.7%	-13.2%	-9.9%
S&P/TSX Small Cap	-13.4%	-20.8%	-14.2%
S&P 500 (US$)	-8.3%	-16.1%	-20.0%
Russell 2000 (US$)	-8.2%	-17.2%	-23.4%
MSCI EAFE (US$)	-9.3%	-14.3%	-19.3%
MSCI EM (US$)	-6.6%	-11.3%	-17.5%
Commodities (CRB Index)	**-7.9%**	**-1.1%**	**25.7%**
WTI Oil (US$/barrel)	-6.1%	7.4%	43.1%
Gold (US$/ounce)	-2.1%	-6.9%	-0.9%
Copper (US$/tonne)	-12.6%	-20.4%	-15.3%
Forex (DXY - USD Index)	**2.9%**	**6.5%**	**9.1%**
USD per EUR	-2.4%	-6.0%	-8.1%
JPY per USD	5.5%	11.6%	17.9%
CAD per USD	1.8%	3.0%	1.9%

CIO Office (data via Refinitiv)

Fixed Income

- Following slight relief in May, June again saw significant losses for fixed-income securities as the Federal Reserve and the Bank of Canada turned even more hawkish on inflation. This is the sixth consecutive month of losses for the Canadian bond universe, down 5.5% for the quarter and 11.9% year-to-date.
- In the U.S., as recession fears grew, high-yield corporate bonds fell more than the safer investment-grade bonds.

Equities

- June was a very difficult month for global equity markets as investor sentiment was undermined by persistent inflation, Fed tightening, and recession fears. The energy sector, which had performed extremely well in the first five months of the year, also suffered heavy losses in June as oil prices fell.
- Emerging markets slightly outperformed the rest of the world for the quarter, as China announced new stimulus measures and relaxed public health restrictions.

FX & Commodities

- Most commodity prices declined in June, including oil, gold, copper, and several agricultural commodities.
- With investor sentiment deteriorating significantly during the month, the U.S. dollar resumed the rally that began earlier this year. The Greenback appreciated 6.5% in Q2 and is now 9.1% stronger than at the beginning of the year.

Fixed Income | Index Plus

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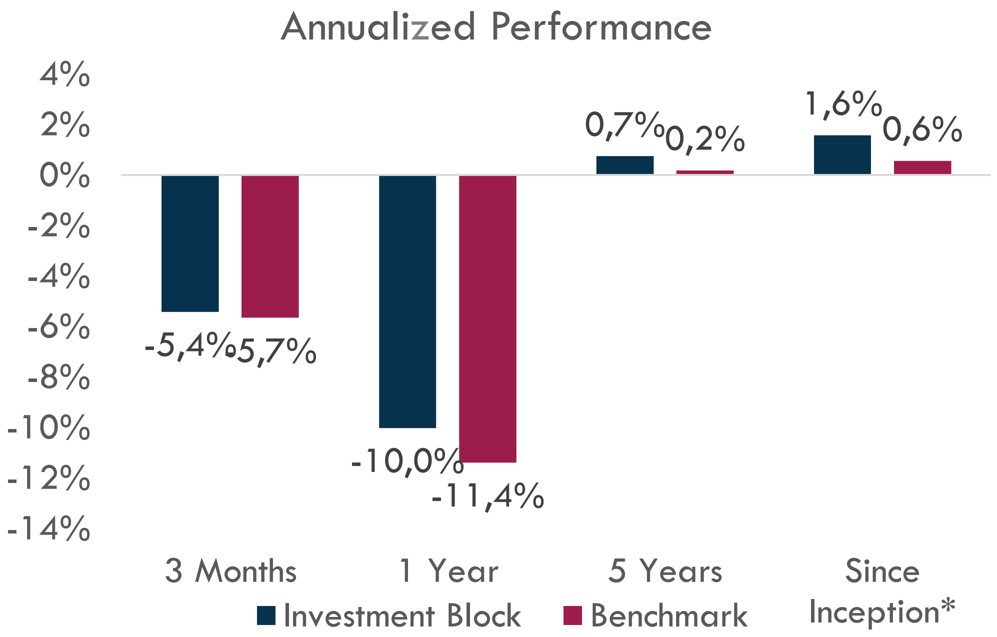
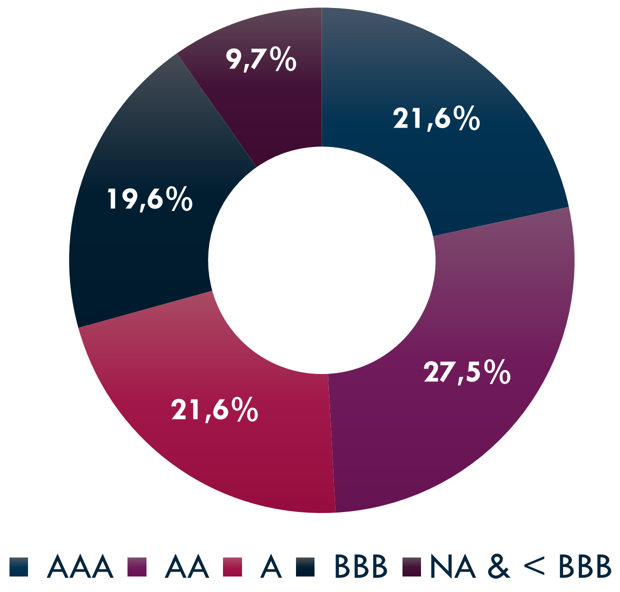




Your Fixed Income investments are divided to diversify, produce steady income, and protect your money. Cost is managed to ensure you retain as much of your income as possible.

Target Asset Allocation

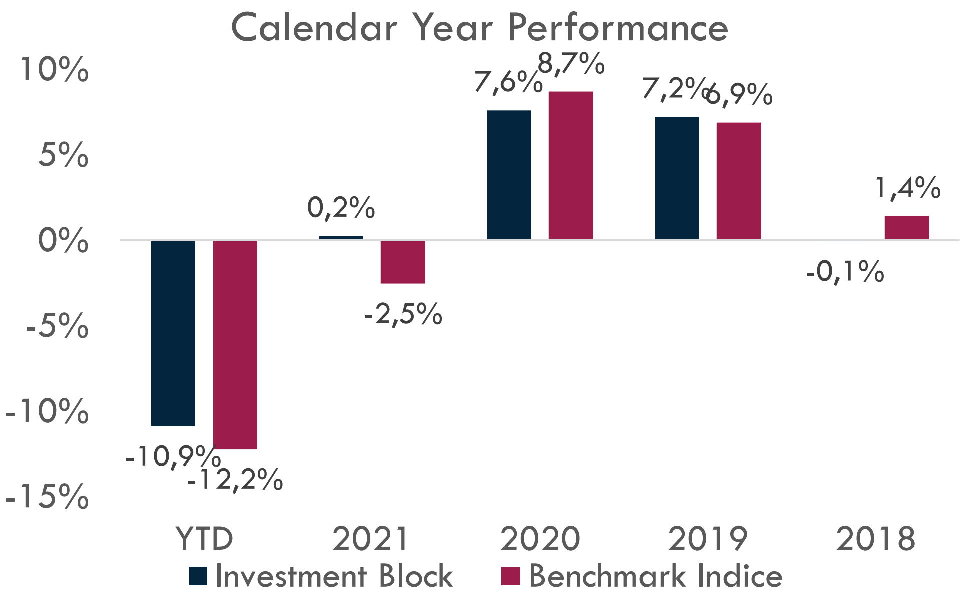
iShares High Quality Canadian Bond	25.2%
Horizons Active Corporate Bond	20.0%
iShares Core Canadian Universe Bond	19.9%
PIMCO Monthly Income ETF	14.9%
BMO Mid Provincial Bond	10.0%
Horizons Active Preferred Share ETF	10.0%

Benchmark

FTSE Canada Universe Bond

Morningstar Peer Group Category

Canadian Fixed Income



Comments

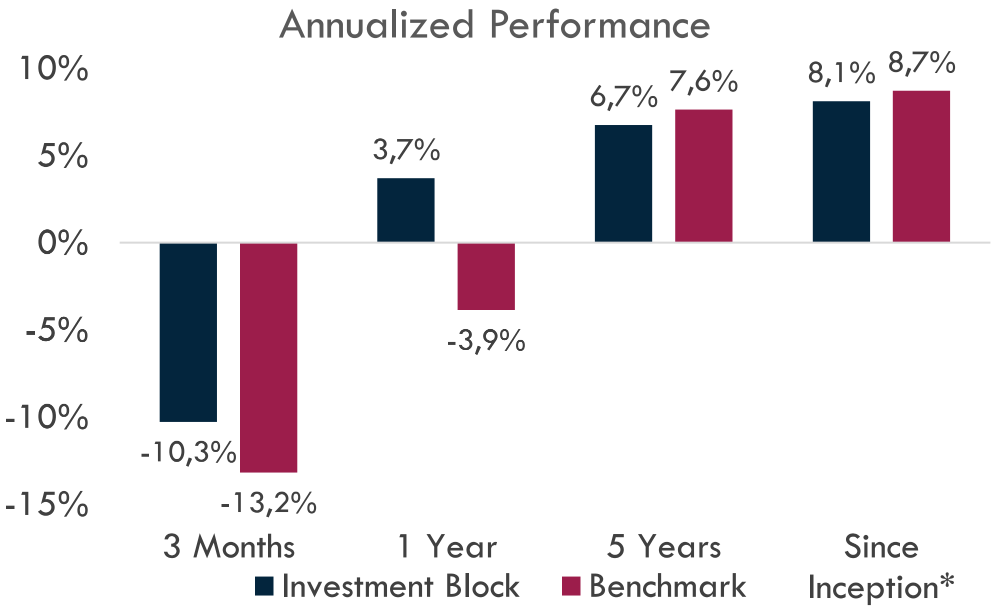
Shorter duration than the benchmark.

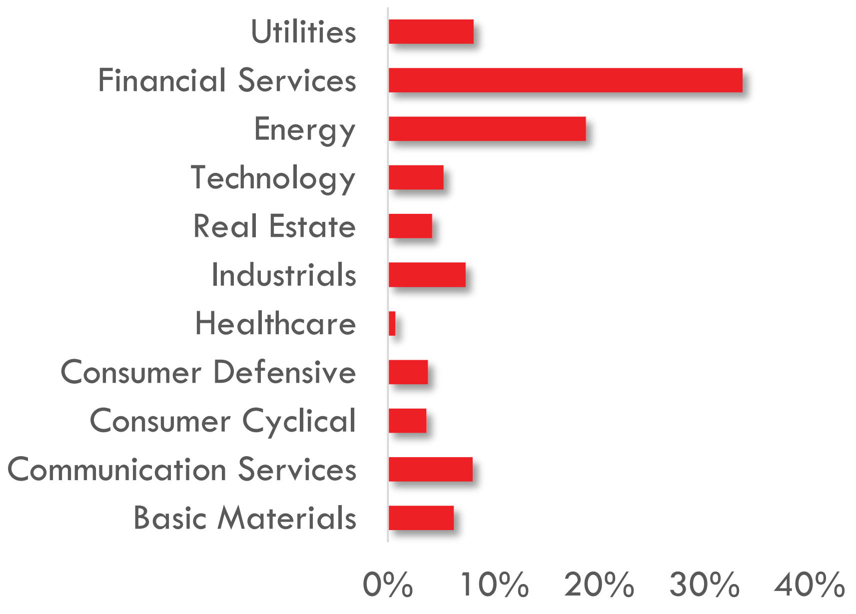
Overweight in quality corporate bonds.

Small portion invested in preferred equity to increase income and protect against inflation.

Canadian Equity | Income Blend

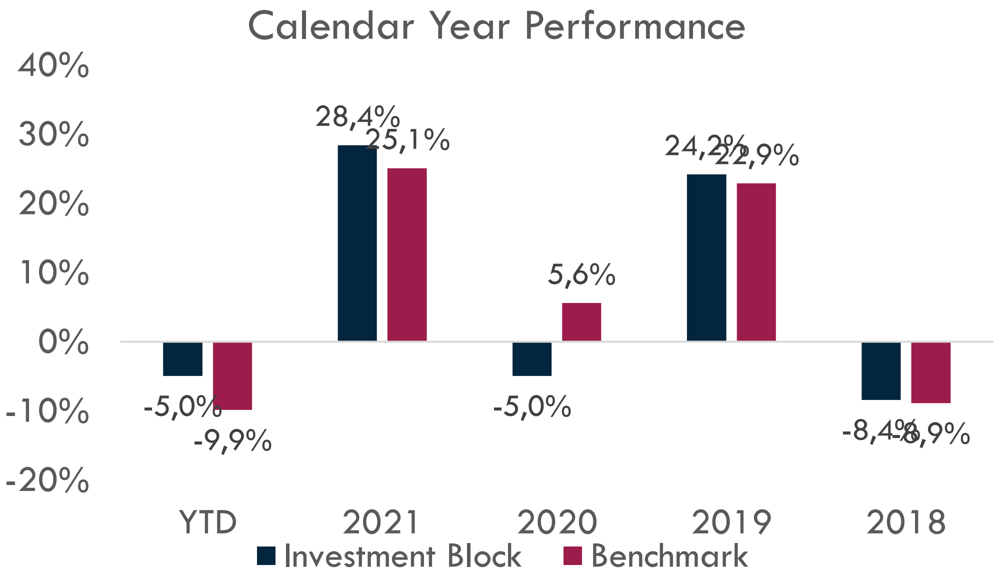
Your Canadian equity holdings are comprised of a blend of hand selected and broad-based investments, designed to achieve the ideal combination of wealth preservation, long term investment results, and cost control.





Target Asset Allocation

NBI Equity Income (Montrusco Bolton)	25.5%
iShares S&P/TSX High Dividend Composite Index	24.6%
Mackenzie Canadian Dividend	20.4%
Fidelity Canadian Core Equity	14.9%
BMO S&P/TSX Composite Index	14.6%



Benchmark

S&P/TSX Composite TR

Morningstar Peer Group Category

Canadian Equity

Comments

Overweight in large cap stocks compared to the index.

Bias for value and dividend-paying stocks.

Overweight equities from defensive sectors.

Global Equity | Pure Active

Your Global equity holdings are invested by managers with proven track record of identifying high-quality investments from around the world. You will benefit from global growth through hand selected investments.

Target Asset Allocation

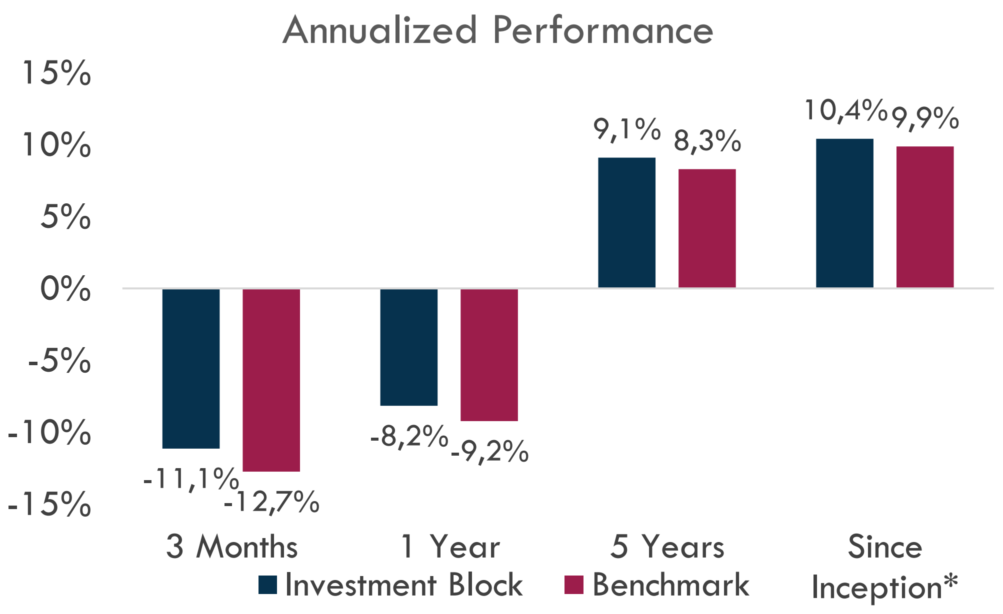
NBI US High Conviction Equity (Fiera)	40.5%
Mackenzie Global Dividend	30.0%
Fidelity International High Quality Index ETF	14.8%
Fidelity American Core Equity	14.6%

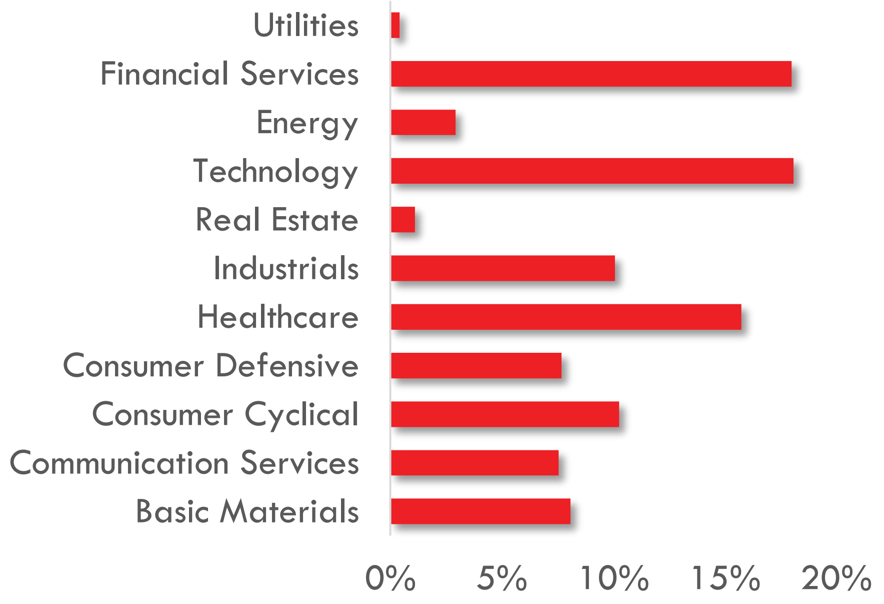
Benchmark

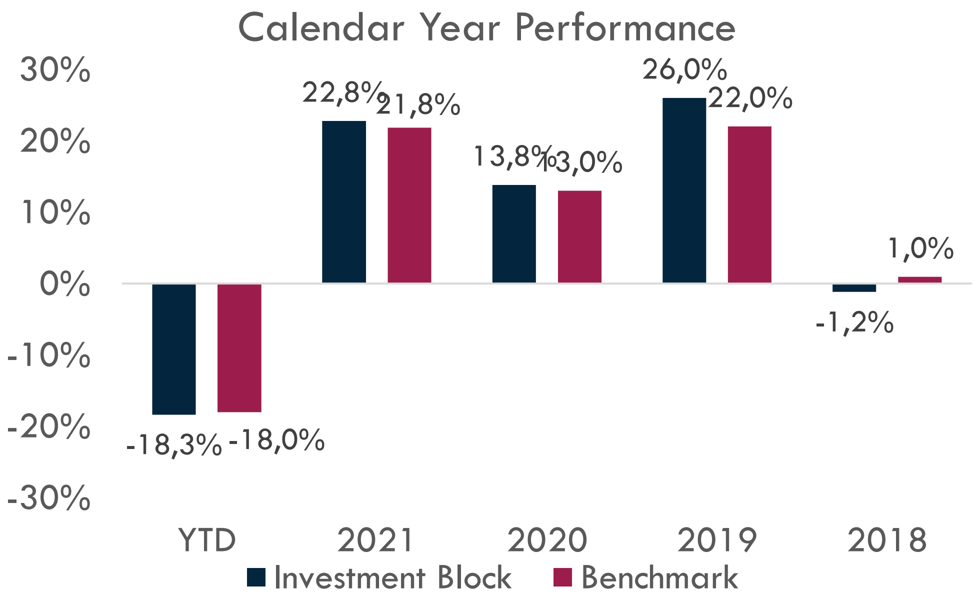
NBF Global Equity Benchmark

Morningstar Peer Group Category

Global Equity







Comments

The market cap is similar to the benchmark.

Overweight position in quality and growth at reasonable price (GARP) stocks.

Overweight in cyclical companies and underweight in interest rate sensitive companies.

Alternatives | Blend

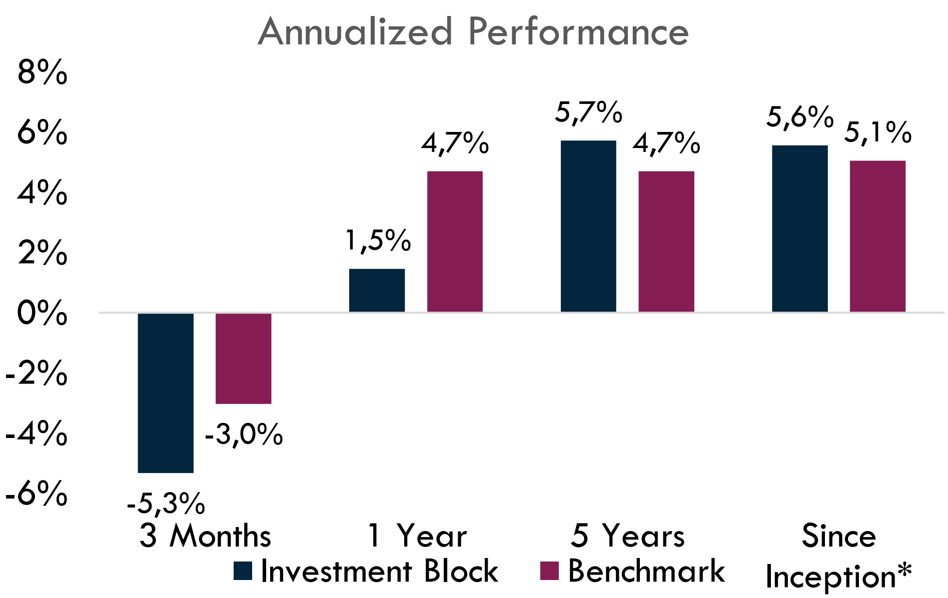
Your holdings in Alternatives will be invested in a combination of publicly traded infrastructure as well as non-traditional strategies, designed to reduce fluctuation within your portfolio and to generate income.

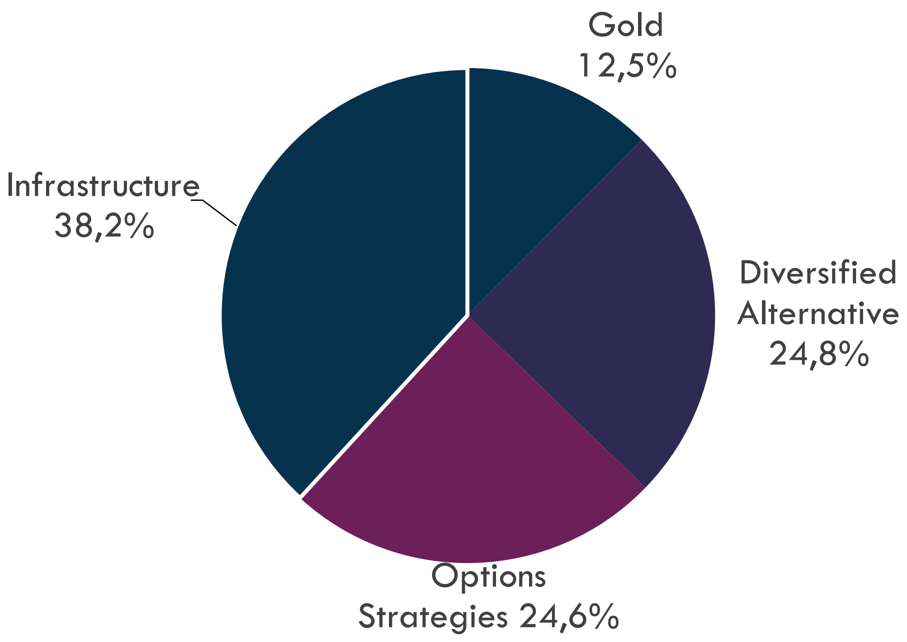
Target Asset Allocation

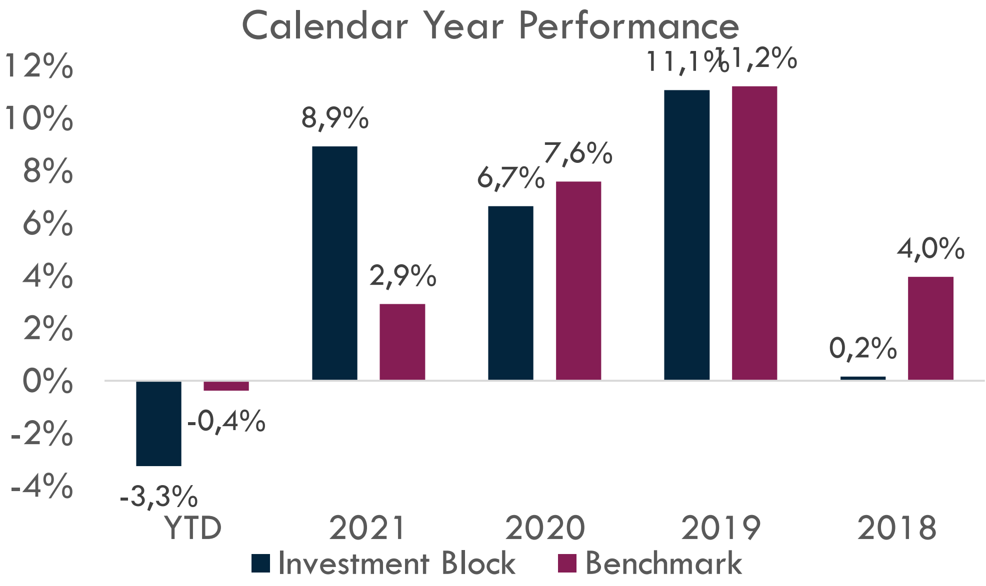
NBI Real Assets Pooled Fund	25.8%
Mackenzie Diversified Alternatives	24.8%
Dynamic Premium Yield	12.6%
iShares Gold Bullion	12.5%
iShares Global Infrastructure Index ETF	12.4%
Structured Payoff Strategies Pooled Fund	11.9%

Benchmark

NBF Alternative Benchmark







Comments

Diversified mix of alternative strategies to smooth out returns and reduce portfolio volatility.

Gold provides protection against inflation and act as insurance policy in market downturns.

Infrastructure and real assets hold a mix of private and listed investments such as real estate, farmlands, timberlands and infrastructure assets that provide regular cash flows, protect against inflation and reduce your portfolio overall risk.

Myths vs Reality and Historical Perspective

Being well informed and remaining objective is essential to maximize your investment success.

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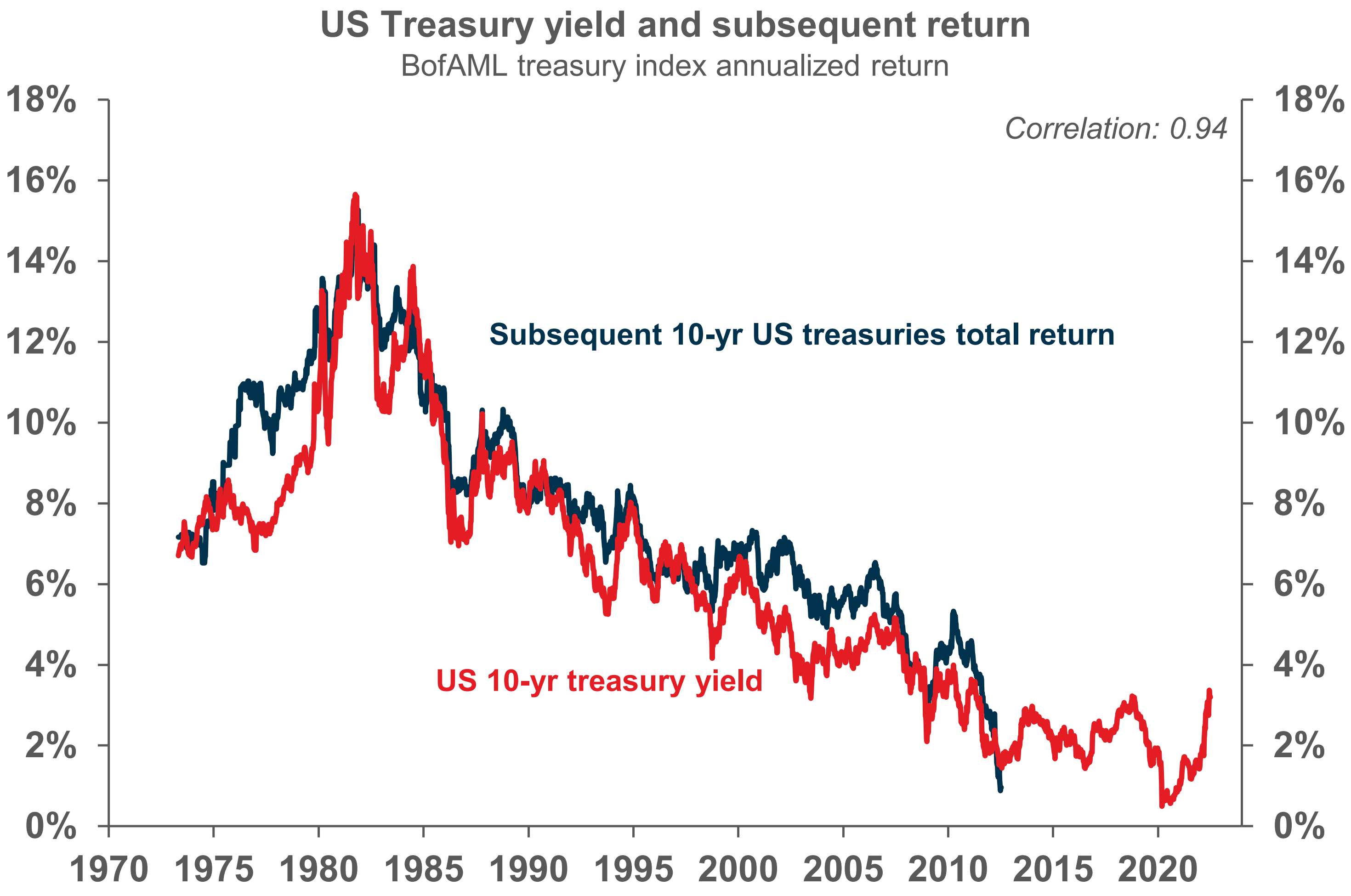
Fixed Income Return Expectations



Over an investment period matching a bond's maturity, subsequent annualized returns will match closely the starting yield to maturity.

In the case of government and investment grade bond indexes, differences between the two measures can occur due to reinvestment risk, the changes in index composition over time, as well as downgrades and defaults for non government bonds.

The Canadian bond universe posted its worst 6 month performance ever in 2022 with a 11.2% decline. However, investors can expect much more attractive return on a forward basis as the current yield to maturity of the index is now just below 4% which will help make up for the heavy losses incurred earlier this year.

CIO Office (data via Refinitiv)

Are Rate Hikes Bad for Stocks?

MYTH

Stocks generally perform poorly when central banks hike their policy rate.

REALITY

Each rate hike cycle has its own set of circumstances that often bring additional volatility to markets. However, what fundamentally prompts central banks to raise their policy rate is usually an economy that is showing strength and is expected to continue to do so; a typically favorable environment for stocks.

Case in point: since 1996, the yearly total return of the S&P/TSX averages 5.8% (8% for the S&P 500) when the Bank of Canada (Federal Reserve) hikes the overnight rate at least once, slightly lower than the 9.1% (10.6%) average of all years over that same time period but still well into positive territory.

To be clear, these historical trends are no guarantee for any specific year, as evidenced by the first half of 2022 whose unique circumstances led to substantial setbacks for stocks. Nevertheless, over the long run, **odds remain in favor of patient investors, with periods of rate hikes being no exception!**

Markets and rate hikes (data since 1996)

Canada

Year	# of rate hikes*	Total return (S&P/TSX)
1997	5	15.0%
1998	3	-1.6%
2000	4	7.4%
2002	2	-12.4%
2005	3	24.1%
2006	4	17.3%
2010	3	17.6%
2017	2	9.1%
2018	3	-8.9%
2022 (YTD)	5	-9.9%
Average (rate hikes)		**5.8%**
Average (all years)		**9.1%**

United States

Year	# of rate hikes*	Total return (S&P 500)
1997	1	33.4%
1999	3	21.0%
2000	4	-9.1%
2004	5	10.9%
2005	8	4.9%
2006	4	15.8%
2015	1	1.4%
2016	1	12.0%
2017	3	21.8%
2018	4	-4.4%
2022 (YTD)	6	-20.0%
Average (rate hikes)		**8.0%**
Average (all years)		**10.6%**

*1 hike = 25 bps net change in policy rate.

CIO Office (data via Refinitiv)

Market Timing in the Long Run

MYTH

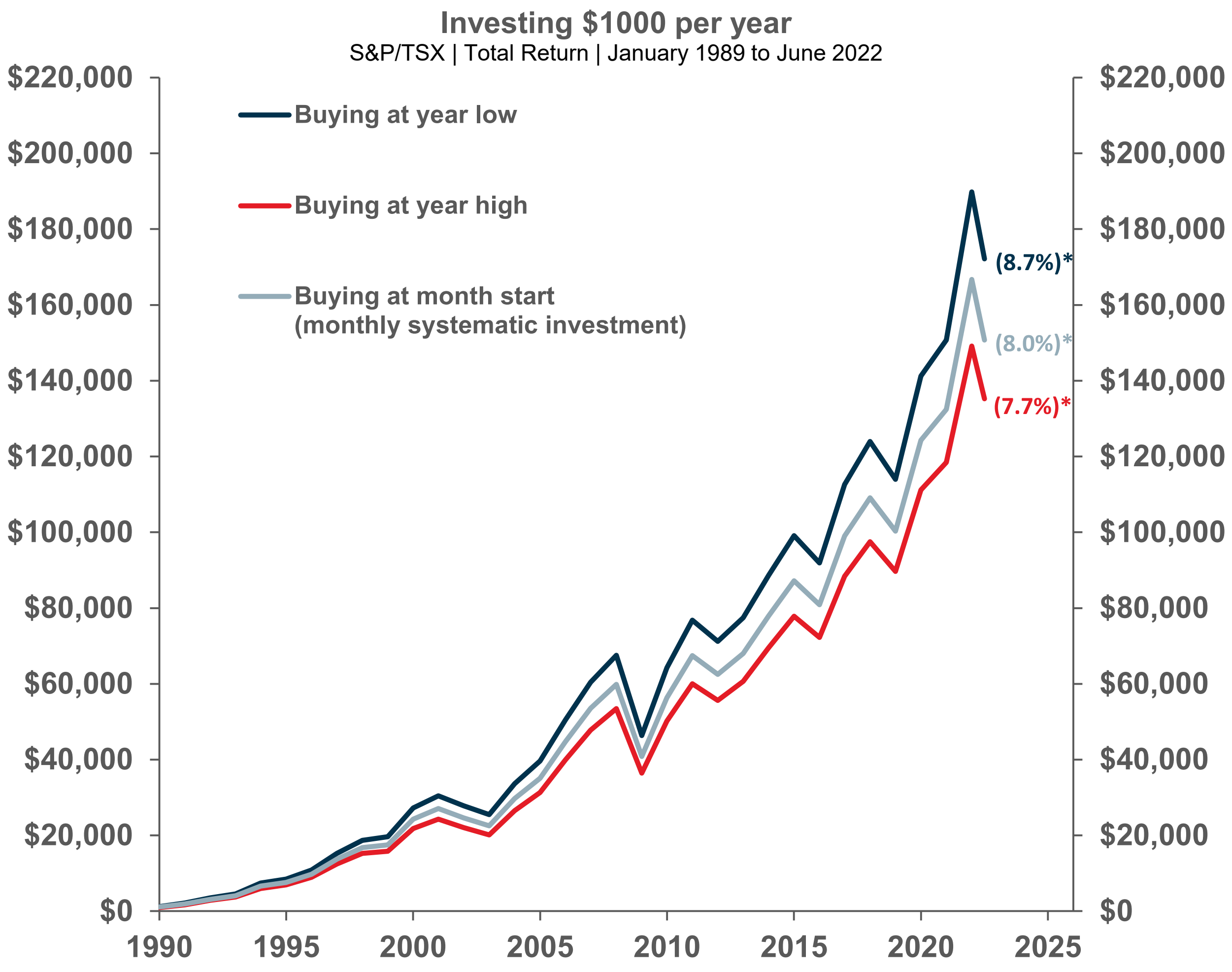
The timing of your annual savings investment is of utmost importance for the well-being of your portfolio in the long run.

REALITY

The timing of your annual savings investment will make a difference in the long run, but it is far from being the critical factor many seem to believe.

Case in point: consider an investor blessed with the power of perfect market timing (blue line) compared to another investor cursed with systematically picking the worst possible day to invest each year, over 30 years (red line). In the end, the market timing champion would have outperformed the most unfortunate of all investors by a mild 1%/year. If we take the more realistic example of an investor saving systematically at the beginning of each month, this annual outperformance shrinks below 1%.

How is such a small gap possible? Simply because in the long run, the first year's return is superfluous. **What truly matters is the frequency of savings and passage of time, not market timing.**



CIO Office (data via Refinitiv)

Reasons to Sell?

MYTH

Selling in times of heightened uncertainty can protect investments from heavy losses.

REALITY

Selling in times of heightened uncertainty is generally the best way to ensure heavy losses, as it often rhymes with selling low and missing the rebound.

More importantly, one should keep in mind that **the only certainty is that there will always be uncertainty, as it is the price to pay for capital appreciation in the long run.**

And – need we add – it isn't in the media's best interest to report the latest news with nuance and historical perspective; better to let fear and pessimism easily set in. However, **the chart on the right should act as a reminder that letting emotions take over is a good recipe for short-term gain, but long-term pain.**

CIO Office (data via Refinitiv)

Average Return?

MYTH

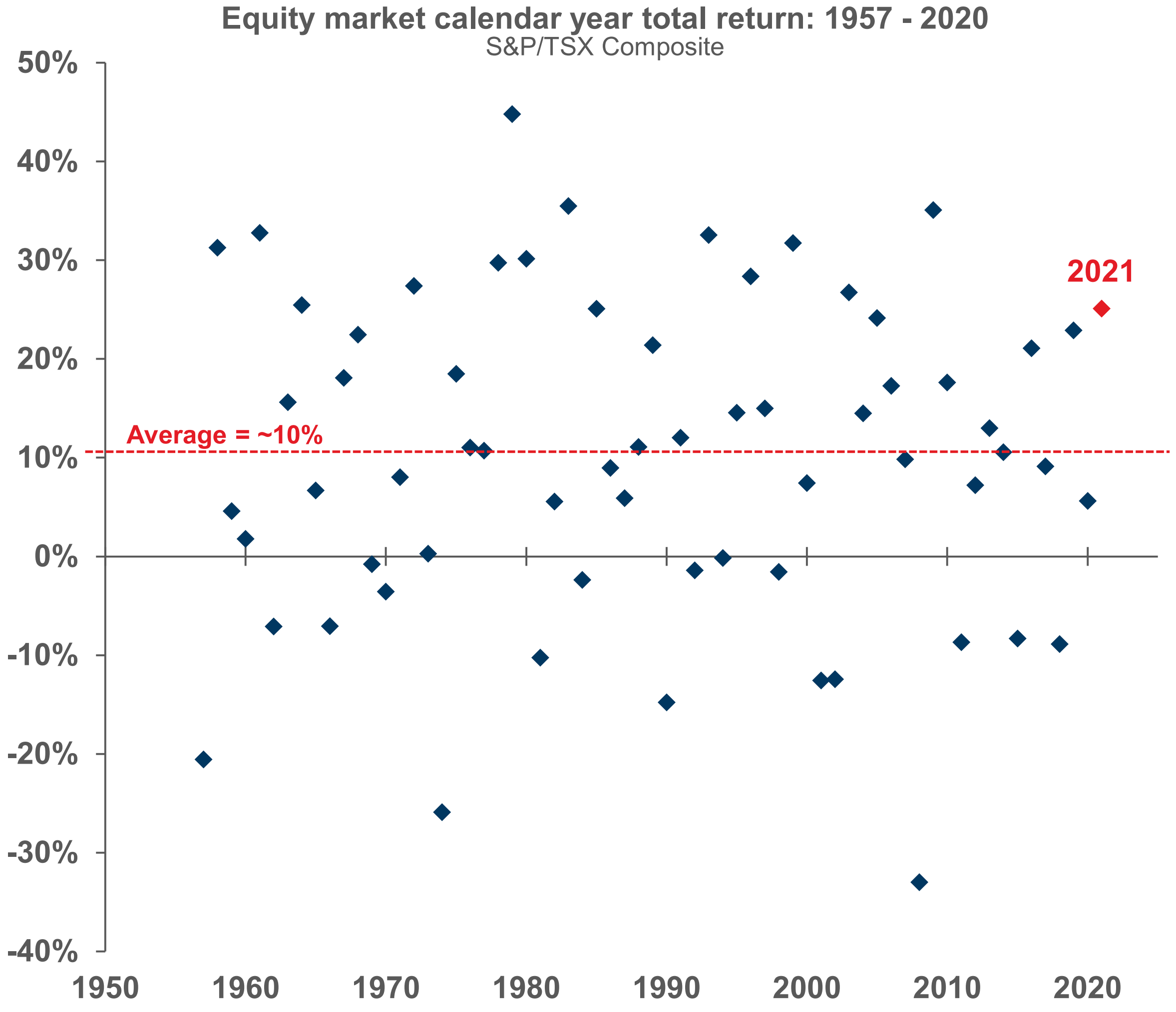
Since the long-term historical average annual return on the stock market is ~10%, investors should expect to see calendar-year returns near 10%.

REALITY

Quite the contrary, it is likely that investors will only rarely see a calendar year where equity returns are close to their long-term historical averages. Case in point: since 1957, only 8 years out of 63 have seen the Canadian stock market generate performance near average (+/- 2%).

One likely reason for this myth is the common misconception that "average" is synonymous with "typical." However, there is no such thing as a "typical" year in the stock market.

As a result, **investors should expect a wide range of possible outcomes in any given year, whereas only the passage of time can lead to an annualized return near the market's long-term average.**



CIO Office (data via Refinitiv)

Equity Performance in the Long Run

MYTH

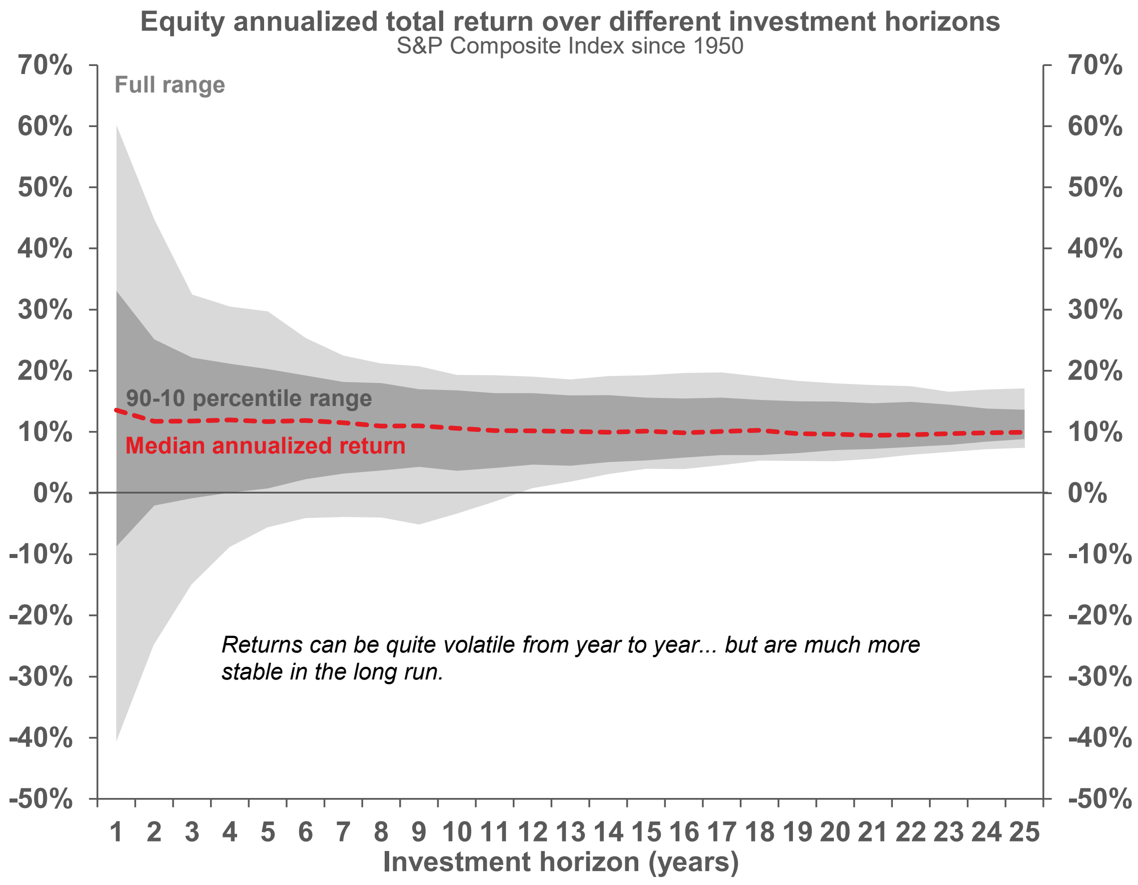
Investing in the stock market is akin to gambling at a casino.

REALITY

It is true that daily market fluctuations resemble a coin toss. Nevertheless, two fundamental reasons make investing completely different from gambling.

First, unlike the world of gambling, investing in the stock market is not a zero-sum game, as evidenced by the positive median annualized return (red dotted line). In the long run, equity returns come from companies' ability to grow their earnings, not from other investors' misfortune.

Second, while gambling remains just as uncertain no matter how long you "play", the opposite occurs within equity markets, as evidenced by the narrowing range of outcomes over time (grey area). The longer one "plays" (i.e. remains invested), the greater the chances are of converging towards the premium investors earn for bearing equity risk.



CIO Office (data via Robert J. Shiller at http://www.econ.yale.edu/~shiller/data.htm)

Home Country Bias

MYTH

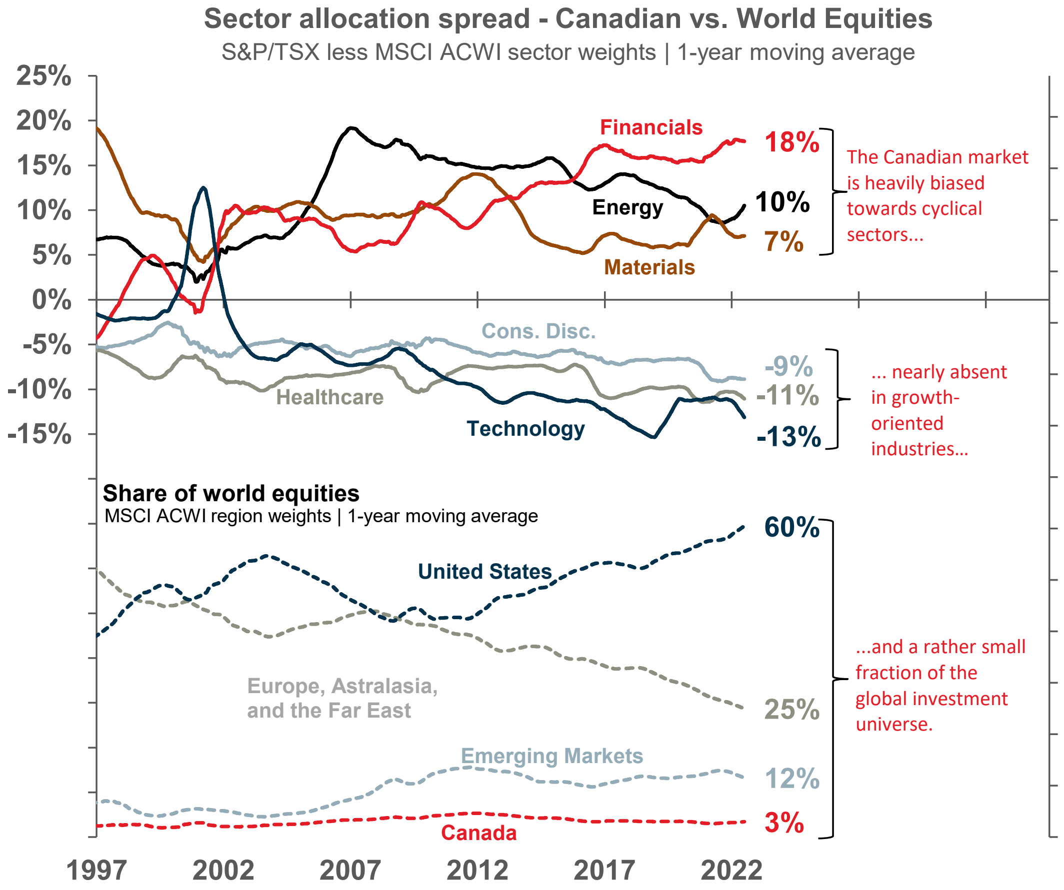
It is more prudent to invest most of your portfolio in companies domiciled at home and thus of greater familiarity than to "risk it" with foreign corporations.

REALITY

While predominantly investing in domestic equities might seem sufficient and feel comforting, such a portfolio could, in fact, be just the opposite. **Do not confuse familiarity with safety.**

For instance, Canada's stock market's high concentration in some of the most cyclical sectors and its relative lack of growth-oriented companies poses a risk that can result in unpleasant surprises if left undiversified.

The good news is that there are plenty of opportunities abroad to complement for such risks. After all, Canadian stocks only represent 3% of the global equity investment universe... a far cry from the ~45% they account for in Canadians' portfolios*. Home bias indeed!



CIO Office (data via Refinitiv) *Estimate base on an average from FMI's

* "Coordinated Portfolio Investment Survey" for 2014-2018.

Should Investors Fear Recessions?

MYTH

Investors should be fearful of recessions as they entail heavy financial losses.

REALITY

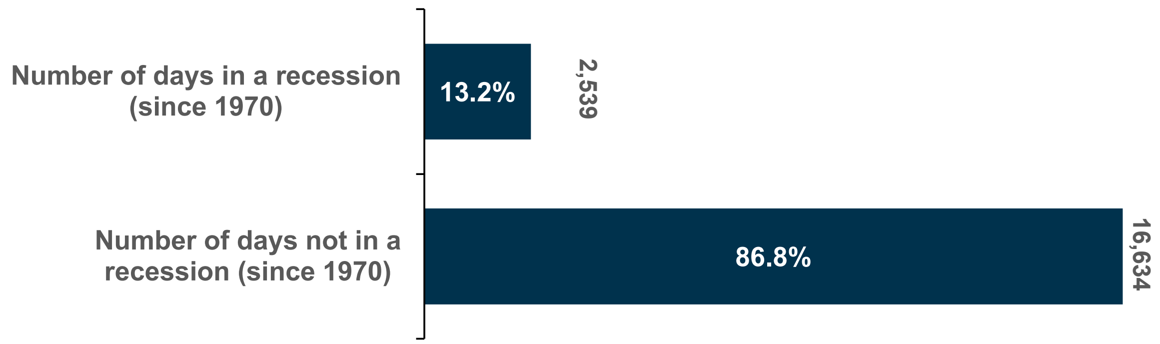
It is true that the most turbulent periods for markets are generally concomitant with recessions. As such, those with eyes riveted on daily stock exchange prices are very likely to experience fear in times of economic downturn.

However, if we step back from market fluctuations and look, rather, at the historical performance of a basic balanced portfolio (60% stocks, 40% bonds) during the last six recessions, we see that the average return was actually zero. Not something to celebrate, but far from the financial catastrophe many seem to believe – especially when we consider returns in the previous and following years. What's more, let's not forget that recessions are relatively rare events, covering only 17% of the last 50 years.

Therefore, **it is not the recession that investors should fear, but fear itself… or rather the risk of materializing heavy losses, when in the grip of emotion, at an untimely moment.**

Balanced portfolio (60/40)* total return

Recessions (NBER)	12-months Before	During Recession	12-months After	Full period**
Nov 1973 - Feb 1975	7%	-7%	12%	11%
Jan 1980 - Jun 1980	11%	9%	7%	31%
Jul 1981 - Oct 1982	9%	15%	26%	57%
Jul 1990 - Feb 1991	4%	6%	9%	21%
Mar 2001 - Oct 2001	-1%	-5%	-8%	-14%
Dec 2007 - May 2009	1%	-16%	9%	-8%
Feb 2020 - March 2020	16%	-9%	22%	28%
Average	**7%**	**-1%**	**11%**	**18%**



*60% MSCI World (in CAD) 40% FTSE TMX Bond Universe (FTSE 91-day index for the 1973-1975 recession). **Total return from 12-months before a recession until 12-months after a recession. Recession dates are from the NBER.

CIO Office (data via Refinitiv)

Are GICs a Risk-Free Alternative?

MYTH

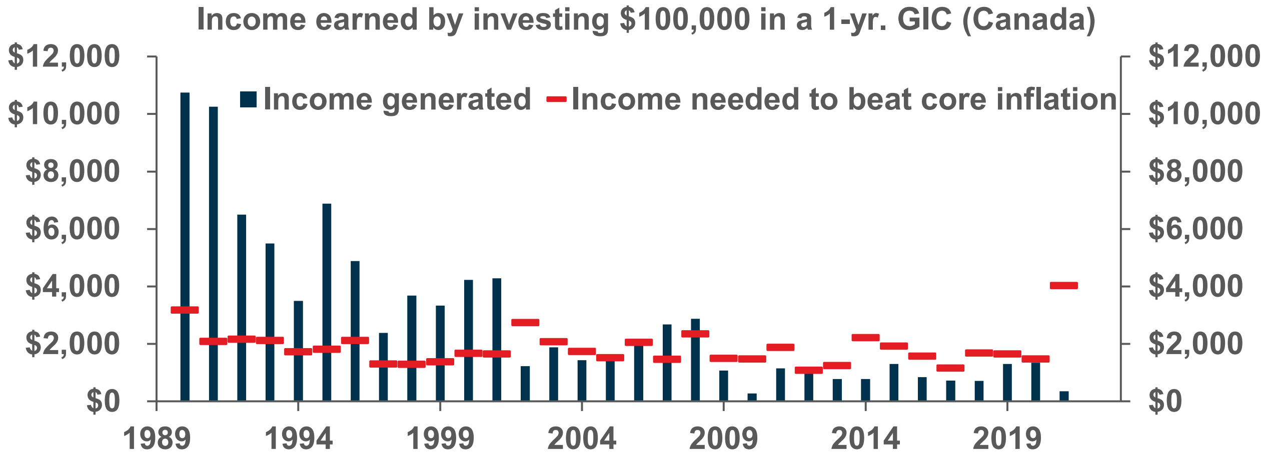
Guaranteed Investment Certificates (GICs) offer a risk-free alternative for investors seeking to at least preserve the purchasing power of their assets.

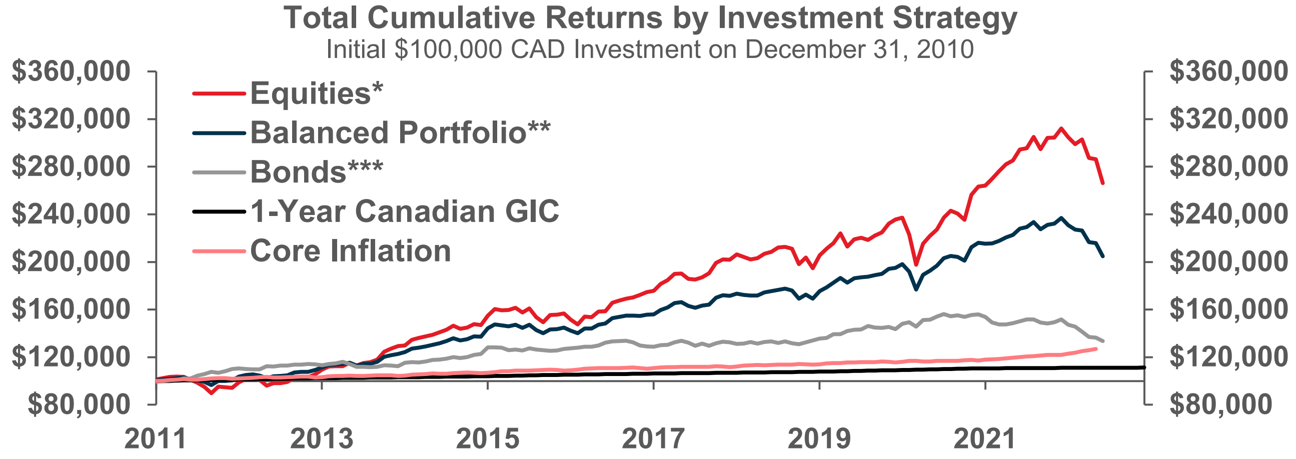
REALITY

GICs are indeed among the safest investment vehicles available. However, their returns, while guaranteed, generally fail to cover inflation, leaving their holders at risk of seeing their purchasing power decline over time.

It should be specified that this observation is a reflection of the low interest rate environment prevailing over the past several years. For instance, although a 1-year GICs provided income above inflation in the 1990s, this has not been the case since 2009.

Ultimately, the selection of an investment vehicle depends on risk tolerance - GICs may therefore be the right choice for some. However, **a key risk for investors whose investment horizon is measured in years may not be the short-term volatility of other assets, but rather the potential erosion of their purchasing power over the long run.**





**35% S&P 500, 35% S&P/TSX, 20% MSCI EAFE, 10% MSCI EM; all in CAD.*
***60% Equities, 40% Fixed Income*
****100% FTSE Canada Universe*

CIO Office (data via Refinitiv)

Back to basics: Diversification

Over short periods of time, asset classes will take turns out-performing and under-performing. A diversified portfolio helps protect your investments against market fluctuations.

Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022
S&P 500 20.5%	Can. Pref. Shares 11.4%	MSCI Emerging 19.8%	Commodities 13.5%	Commodities 15.7%	Commodities 5.2%	S&P 500 11.0%	Commodities 33.1%	Commodities 2.0%
MSCI Emerging 18.2%	MSCI Emerging 9.7%	MSCI EAFE 16.1%	Can. Pref. Shares 8.8%	S&P 500 8.5%	Can. Pref. Shares 2.8%	S&P/TSX 6.5%	Gold 6.6%	Cash 0.3%
S&P/TSX 17.0%	S&P 500 8.9%	Commodities 14.5%	S&P/TSX 8.1%	S&P/TSX 8.5%	US High Yield 0.9%	**Balanced*** **4.5%**	S&P/TSX 3.8%	CADUSD -2.9%
MSCI EAFE 15.1%	MSCI EAFE 4.9%	S&P 500 12.1%	S&P 500 6.2%	MSCI EAFE 5.4%	S&P 500 0.6%	Gold 4.0%	CADUSD 1.1%	Canadian Bonds -5.5%
Can. Pref. Shares 15.0%	S&P/TSX 4.7%	S&P/TSX 9.0%	MSCI EAFE 3.6%	MSCI Emerging 5.1%	**Balanced*** **0.2%**	MSCI EAFE 2.7%	Cash -0.1%	Can. Pref. Shares -7.5%
Gold 12.1%	US High Yield 4.7%	Can. Pref. Shares 7.3%	MSCI Emerging 2.3%	Can. Pref. Shares 5.0%	S&P/TSX 0.2%	Canadian Bonds 1.7%	Can. Pref. Shares -2.5%	Gold -7.6%
Balanced* **11.1%**	Commodities 4.6%	US High Yield 6.5%	CADUSD 1.4%	**Balanced*** **4.6%**	Cash 0.1%	Can. Pref. Shares 1.6%	**Balanced*** **-4.4%**	**Balanced*** **-9.7%**
Commodities 10.5%	Gold 3.6%	**Balanced*** **5.7%**	US High Yield 0.9%	Gold 3.2%	MSCI EAFE -0.4%	Commodities 1.5%	US High Yield -4.5%	US High Yield -10.0%
US High Yield 9.6%	**Balanced*** **3.5%**	CADUSD 4.6%	**Balanced*** **0.9%**	US High Yield 2.8%	Canadian Bonds -0.7%	US High Yield 0.7%	S&P 500 -4.6%	MSCI Emerging -11.3%
Canadian Bonds 5.8%	CADUSD 1.9%	Canadian Bonds 0.4%	Cash 0.0%	Canadian Bonds 1.8%	Gold -1.0%	CADUSD 0.3%	MSCI EAFE -5.8%	S&P/TSX -13.2%
CADUSD 3.6%	Canadian Bonds 0.6%	Cash 0.1%	Canadian Bonds -5.3%	CADUSD 1.3%	CADUSD -2.2%	Cash 0.1%	Canadian Bonds -6.8%	MSCI EAFE -14.3%
Cash 0.2%	MSCI Emerging 9.7%	Gold -0.4%	Gold -9.8%	Cash 0.0%	MSCI Emerging -8.0%	MSCI Emerging -1.2%	MSCI Emerging -6.9%	S&P 500 -16.1%

*Balanced = 40% FTSE TMX Universe, 21% S&P/TSX, 21% S&P 500 ($C), 12% MSCI EAFE ($C), 6% MSCI EM ($C)

CIO Office (data via Refinitiv)

Historical Perspective on Bear Markets

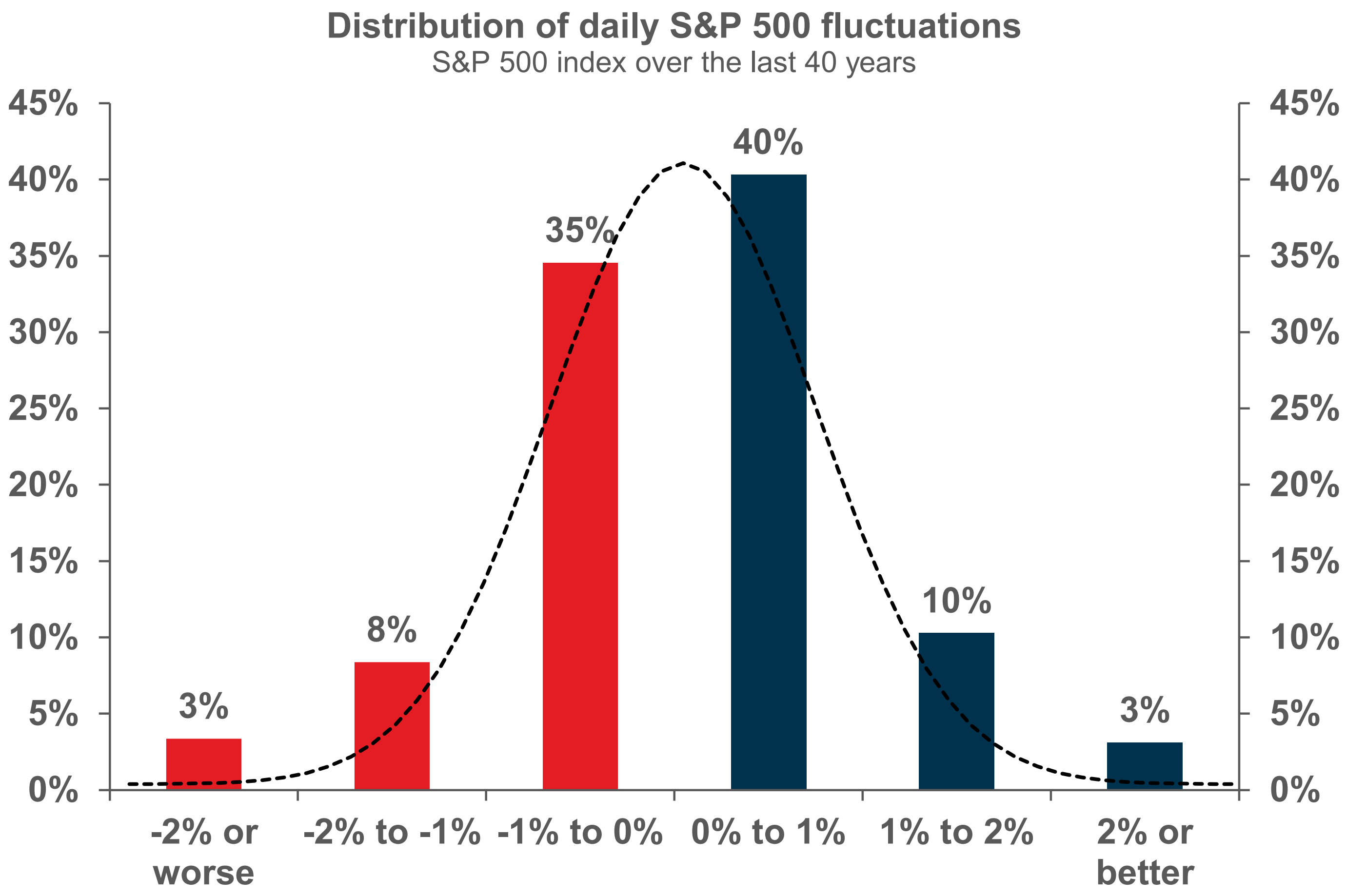
S&P 500 Bear Markets (1950-2022)

Peak	Trough	# days	Period Drawdown	# days to recover	Cumulative price return over the following: 6 months	12 months	24 months	36 months
1956-08-02	1957-10-22	446	-22%	337	8%	31%	47%	42%
1961-12-12	1962-06-26	196	-28%	434	20%	34%	53%	71%
1966-02-09	1966-10-07	240	-22%	209	22%	32%	37%	30%
1968-11-29	1970-05-26	543	-36%	650	19%	48%	54%	61%
1973-01-11	1974-10-03	630	-48%	2,114	35%	37%	68%	54%
1980-11-28	1982-08-12	622	-27%	83	43%	58%	48%	88%
1987-08-25	1987-12-04	101	-34%	600	13%	19%	50%	35%
2000-03-24	2002-10-09	929	-49%	1,694	13%	28%	45%	57%
2007-10-09	2009-03-09	517	-57%	1,480	48%	63%	96%	94%
2020-02-19	2020-03-23	33	-34%	148	52%	74%	99%	--
2022-01-03	2022-06-16	164	-23%	--	--	--	--	--
	Average:	**402**	**-35%**	**775**	**27%**	**43%**	**55%**	**59%**

Ibbotson. S&P 500 bear markets are defined as periods when the index fell at least 20% from its all time high.

CIO Office (data via Refinitiv)

Daily Stock Market Fluctuations



Market fluctuations are normal, both mathematically* and literally. While only the few "extremes" end up in the evening news and morning shows, the truth is they don't matter all that much.

What really matters is the accumulation of "0% to 1%" days that rarely make the headlines, but explain much of the 12.3% S&P 500 annualized total return over the last 40 years…

…despite the fact that the index closes in the red almost every other day.

Ibbotson. S&P 500 bear markets are defined as periods when the index fell at least 20% from its all time high.

CIO Office (data via Refinitiv)

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The NBF Balanced Benchmark consists of 5% FTSE TMX 91 day T-Bill, 40% FTSE TMX Universe Bond, 18% S&P TSX Composite Total Return, 18% S&P 500 $CAD Total Return, 9% MSCI EAFE $CAD Total Return, and 10% of the NBF Alternative benchmark. The NBF Alternative Benchmark consists of 33% HFRX Equal Weighted Strategies Index ($CAD), 33% S&P Global Infrastructure Index ($CAD), and 33% Gold ($CAD). The NBF Global Equity Benchmark consists of 66% S&P 500 $CAD and 33% MSCI EAFE $CAD.