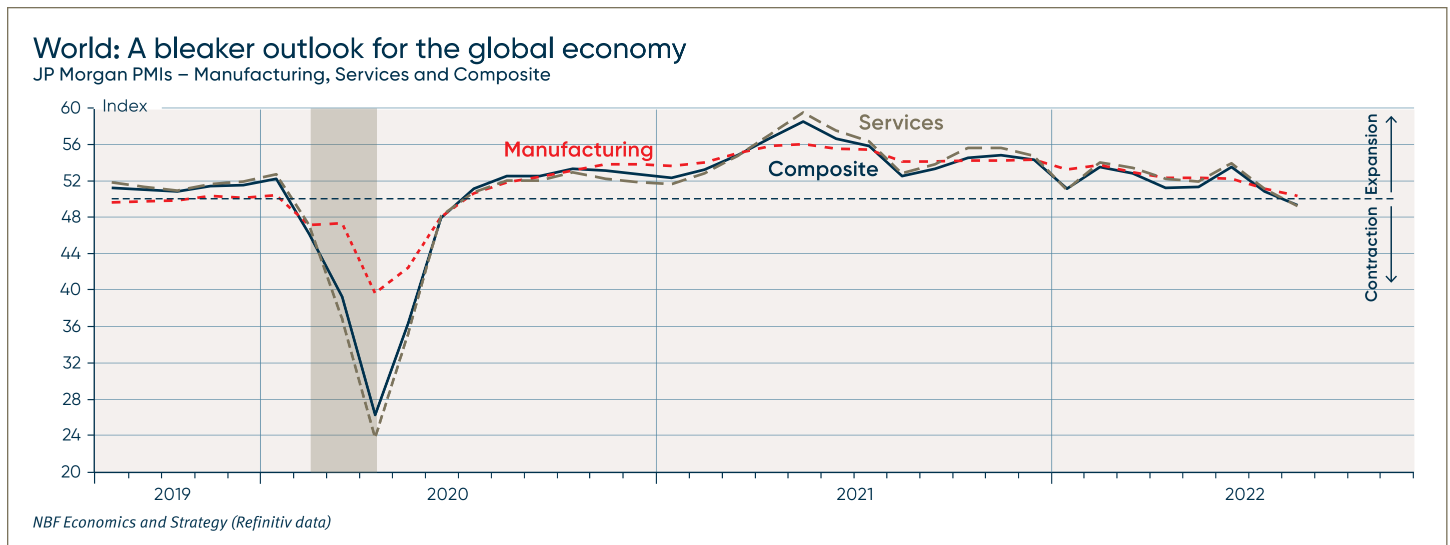
September 2022
Building your financial future

Investment Strategy

World

A global recession can still be avoided, provided that inflationary pressures subside relatively quickly and that monetary policies do not become overly restrictive. There has certainly been some good news on the inflation front recently. Oil prices briefly slipped below $90 per barrel and food prices continued to fall, but this improvement was largely driven by concerns about the global economy. The downturn was particularly pronounced in the Eurozone, where the decline in some commodity prices was completely overshadowed by the rise in natural gas prices following Russia's decision to halt deliveries to continental Europe through the Nord Stream 1 pipeline. This was compounded by widespread droughts that led to a drop in the level of several major rivers this summer, limiting agricultural production and raising the cost of transporting goods. At the same time, the European central Bank raised its key interest rates by 75 basis points, which could further dampen growth and risk bringing to the forefront some of the vulnerabilities that surfaced a decade ago during the debt crisis, amplifying the effects of a recession that now seems inevitable. The situation is no better in emerging countries, which have to deal with a significant appreciation of the greenback because a significant proportion of their borrowings are denominated in USD. Meanwhile, China is stubbornly sticking to its zero COVID policy, with repeated closures that will not be without consequences for the economy, especially as they are added to a slowdown in the real estate sector and severe droughts in Sichuan. The central bank did respond by lowering its policy rates, but this seems to have only pushed the currency down further. In sum, the decline in some commodity prices so far has not had the positive effects we had hoped for, as this has been largely offset by an increase in general uncertainty. As a result, we have lowered our global growth forecast for 2022 in recent months to 2.6% in 2022 and 2.3% in 2023.



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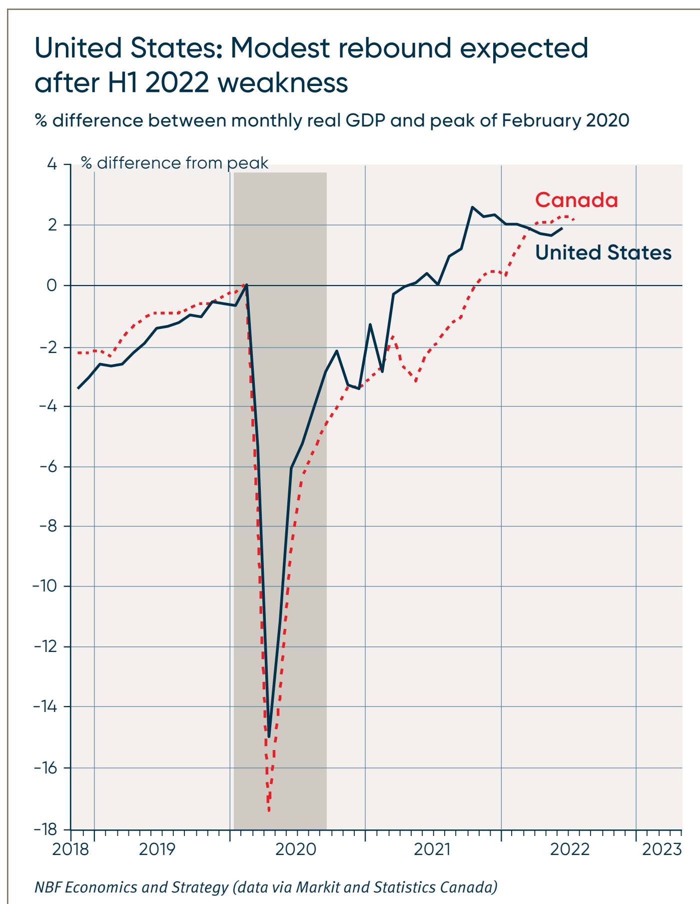
NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

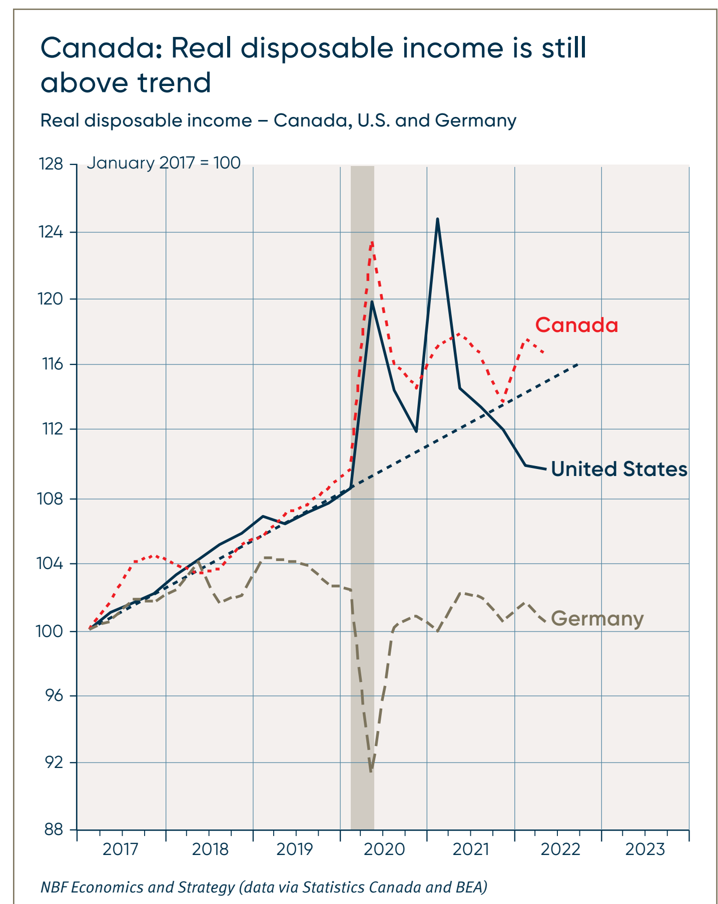
United States

Throughout the summer, the Federal Reserve continued to hammer home the point that its priority is to bring inflation back to target and that it will not shy away from keeping policy rates at a restrictive level for some time to achieve this. In August, Chairman Jerome Powell explicitly acknowledged at the Jackson Hole Economic Symposium that this would not be a smooth process, stating that "reducing inflation is likely to require a sustained period of below-trend growth." Indeed, the sectors most sensitive to interest rate increases, namely the housing sector and business investment, are already showing signs of slowing. We believe that this is not enough to push the economy into recession, as these two components represent a relatively small share of domestic demand. Consumption, on the other hand, could certainly tip the balance in either direction. And while the pace of growth in household spending has slowed somewhat recently, it is still positive, thanks in part to the excess savings accumulated during the COVID crisis and a strong labour market. However, this may not be enough to keep up the pace of consumption, as wages are not keeping pace with inflation and hiring is set to moderate drastically. Therefore, after a modest rebound in Q3, we expect several quarters of below-potential growth for the U.S. economy. Our growth forecast for 2022 is now 1.6% and 0.9% for 2023.

Canada

The Bank of Canada's message is unequivocal. It intends to move interest rates further into restrictive territory next month, even though we see some interesting global developments on the inflation front, including lower energy prices, lower transportation costs and easing supply chain problems. The Bank of Canada is on shaky ground. By acting at high speed and given the lag in the transmission of monetary policy, it does not have time to assess the impact of its actions and adjust if necessary. Unfortunately, we will only know after the fact if it has gone too far and it is therefore normal for observers to be nervous. One thing is certain, we are already seeing a marked slowdown in the economy and the labour market, which leads us to believe that a pause will occur after a final 50-basis-point increase in October and that rates at these levels will not be needed for long (we anticipate rate cuts in the second half of next year). Given the monetary tightening that has taken place, shaky growth for a few quarters seems inevitable, with our growth forecast now at 1.1% in 2023 after the 3.2% recorded in 2022. We believe that the Canadian economy can still avoid a recession with its large resource sector still benefiting from favourable prices, spending governments and households whose incomes have benefited from a dynamic labour market and who have excess savings.





Investment Strategy

The volatility that has plagued financial markets for some time now did not abate during the third quarter—quite the contrary. Indeed, after a spectacular equity rebound in the first half of the quarter, a hawkish speech by the chair of the Federal Reserve abruptly put an end to investors' renewed optimism. In the face of this umpteenth increase in hawkishness from the central bank, expectations of rate hikes rose sharply, despite the slowdown in inflation observed during the summer months. In the end, quarterly performance was slightly positive for North American equities, which had suffered significant losses in the second quarter.

Initially, this summer's market optimism was based on the prospect of a rapid deceleration in inflation that would have allowed central banks to slow—or even halt—their monetary policy tightening in the near future. The first part of the equation does indeed seem to be materializing, with a significant drop in gasoline prices helping to ease inflationary pressures. In addition, prices for a wide range of commodities have fallen significantly in recent months, including wheat, corn, lumber and industrial metals. Finally, the normalization of global supply chains continues to run its course.

However, when it comes to an upcoming central bank pivot, market expectations have proven to be overly optimistic. In order to ensure a definitive victory over inflation, the Fed has made clear its intention to move U.S. monetary policy into restrictive territory by the end of the year, and to stay there for some time. In doing so, the shape of the yield curve—a leading indicator from the bond market—has begun to send signals of increased recession risks, although it has not yet passed the critical threshold. At the same time, the Conference Board's leading economic indicator has just crossed a threshold that has historically preceded every U.S. recession in the past five decades.

In the end, even if a more favourable economic scenario cannot be ruled out definitely, we cannot simply ignore the call for caution that a growing number of leading indicators are currently sending us. Moreover, it now seems clear that a pivot by central banks back to an accommodative monetary policy stance, an essential condition for a sustained market recovery, will at best take some time and at worst require a recession.

As a result, during the month of August, we reduced the weight of equities within our tactical asset allocation for a second consecutive quarter. Thus, our more defensive positioning has a slight underweight in stocks and bonds in favour of cash, which is currently offering its best yield in 14 years in Canada—the flip side of increasingly restrictive monetary policies. In terms of geographic allocation, we maintain our preference for the Canadian equity market, which benefits from an attractive level of valuation and a sector allocation better suited to current conditions. On the other hand, we remain less optimistic about the EAFE region and more specifically Europe, where the difficult energy situation further compromises growth prospects.

MODEL PORTFOLIOS

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%	8.25%	1.75%
	Fixed income (duration: 5.75 years)[1]	60% to 100%	70.0%	68.0%	0.0%
	Canadian equities	0% to 30%	8.0%	8.75%	-0.25%
	U.S. equities		8.0%	7.50%	-1.00%
	Foreign equities		4.0%	2.5%	-0.5%
	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%	9.5%	3.0%
	Fixed income (duration: 5.75 years)[1]	45% to 80%	55.0%	53.0%	0.0%
	Canadian equities	20% to 45%	14.0%	15.0%	-0.5%
	U.S. equities		14.0%	13.0%	-1.5%
	Foreign equities		7.0%	4.5%	-1.0%
	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%	9.0%	3.0%
	Fixed income (duration: 5.75 years)[1]	30% to 65%	40.0%	38.5%	0.0%
	Canadian equities	30% to 65%	18.0%	19.0%	-0.5%
	U.S. equities		18.0%	17.0%	-1.5%
	Foreign equities		9.0%	6.5%	-1.0%
	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%	9.0%	3.0%
	Fixed income (duration: 5.75 years)[1]	20% to 45%	30.0%	28.5%	0.0%
	Canadian equities	40% to 75%	22.0%	23.0%	-0.5%
	U.S. equities		22.0%	21.0%	-1.5%
	Foreign equities		11.0%	8.5%	-1.0%
	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.	Cash equivalents	0% to 30%	5.0%	9.5%	3.5%
	Fixed income (duration: 5.75 years)[1]	0% to 30%	15.0%	13.5%	0.0%
	Canadian equities	55% to 100%	26.0%	27.0%	-0.5%
	U.S. equities		26.0%	25.0%	-1.5%
	Foreign equities		13.0%	10.0%	-1.5%
	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	3.2	1.1
U.S.	-3.4	5.7	1.6	0.9
Inflation %				
Canada	0.7	3.4	6.6	2.6
U.S.	1.3	4.7	7.9	2.9

	September 2022		December 2022		December 2023	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-bills, 91-day)	3.60	3.26	3.75	3.60	2.95	2.75
10-year bond yields	3.25	3.35	3.20	3.25	3.10	3.05
30-year bond yields	3.25	3.50	3.25	3.40	3.10	3.20
Canadian Dollar	US $0.76		US $0.78		US $0.79	

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