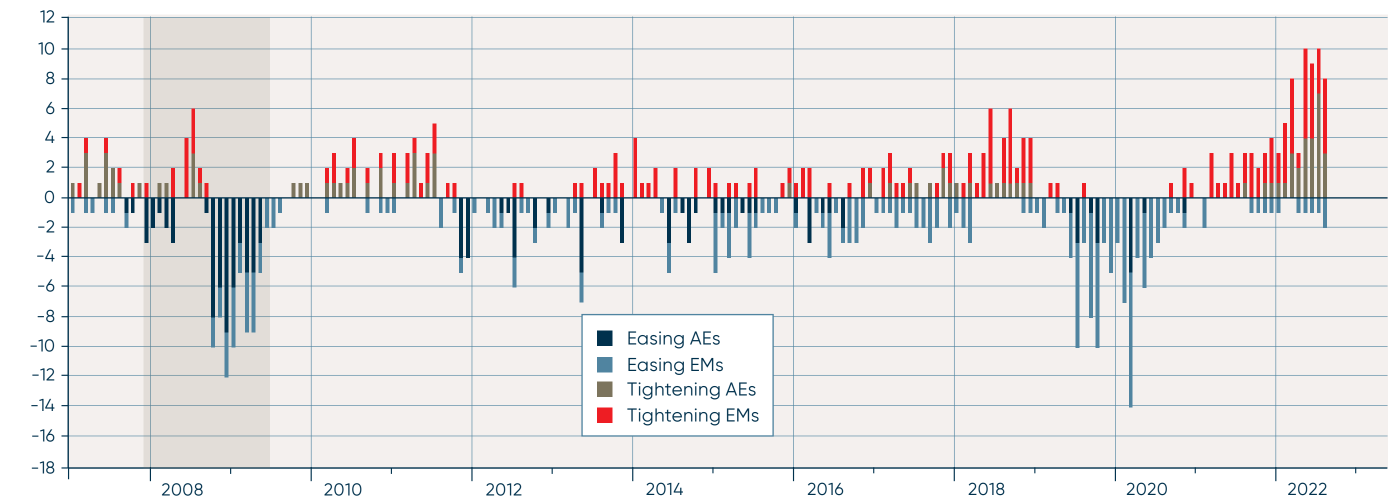
December 2022
Building your financial future

Investment Strategy

World

After a late start, the global monetary policy tightening cycle is well underway, with an increasing number of central banks adopting a tighter approach in an effort to curb inflation. While this reversal of policy offers the prospect of greater price stability in the future, the impact on the economy will be significant, especially since it comes at a time when growth has already slowed considerably in many regions. In the Eurozone, for example, GDP grew at an annualized rate of only 0.7% in Q3, as soaring energy costs were felt through a massive rise in inflation and a corresponding reduction in real earnings. Despite a slight improvement in the energy situation in recent months, there are many signs pointing to the onset of a recession in the final quarter of the year. Retail sales volumes were down sharply in October, suggesting that consumers have bent their knees. Elsewhere in the world, emerging markets are still feeling the impact of the high U.S. dollar, which is putting upward pressure on inflation and making it more difficult to repay U.S. dollar-denominated debt. As a result, several countries are having to raise interest rates even though demand for the goods they produce is faltering after the pandemic frenzy. China, meanwhile, continued to suffer the negative effects of its zero-COVID policy on exports and consumption, in addition to the weakness of the real estate sector. The prospects of easing zero-COVID policy would be encouraging for the economy of the Middle Kingdom and for inflation in the rest of the world. All in all, the global economy is expected to grow by only 2.2% in 2023, following a 3.2% growth in 2022.

World: A synchronized monetary tightening
Number of G20 countries hiking/cutting their policy rates each month



NBF Economics and Strategy (IMF data)

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

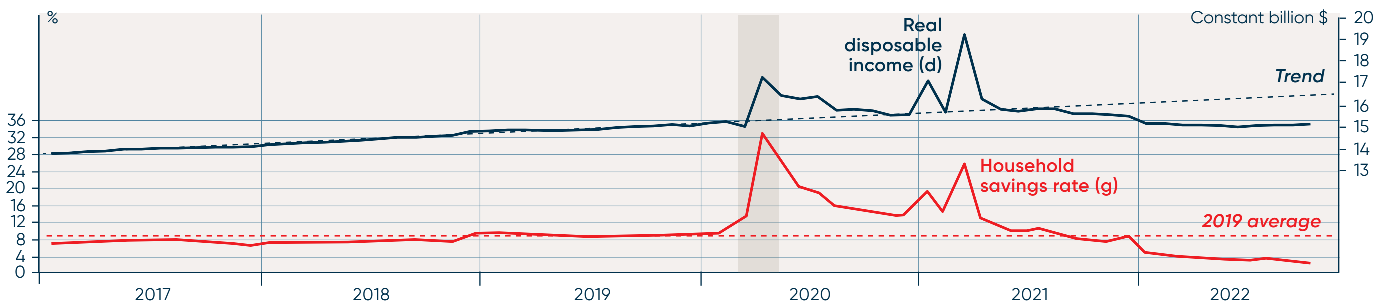
In this issue

United States

There is reason to believe that rate hikes are also coming to an end south of the border as signs of a slowdown are increasing. While third-quarter GDP data showed a rebound in growth, this was primarily due to foreign trade as private domestic demand weakens. Specifically, residential investment fell for a sixth consecutive quarter, a sequence not seen since the Great Recession of 2008-09. Consumption holds up in the fourth quarter but is at risk thereafter as households draw on savings to maintain their standard of living. The downward trend in real incomes points to weakness in 2023. Year-over-year inflation continues to hover at unacceptably high levels, but signs of a turnaround are now abundant, including a slowdown in manufacturing, high inventories, a significant drop in transportation costs, sales price cuts by Chinese producers, and a strong U.S. dollar. For services, the return to inflation levels may take longer, but there is reason to believe that hiring will decline significantly in a context of sluggish growth, contributing to a decrease in wage pressures. This environment should allow the central bank to stop its monetary tightening cycle by the first policy meeting of 2023. Otherwise, a recession would become difficult to avoid in 2023. Even then, a Fed pivot would not prevent a significant slowdown in growth next year. We expect the first half of next year to be difficult, resulting in an expansion of only 0.2% for the full year.

United States: Households are dipping into their savings

Real disposable income and household savings rate



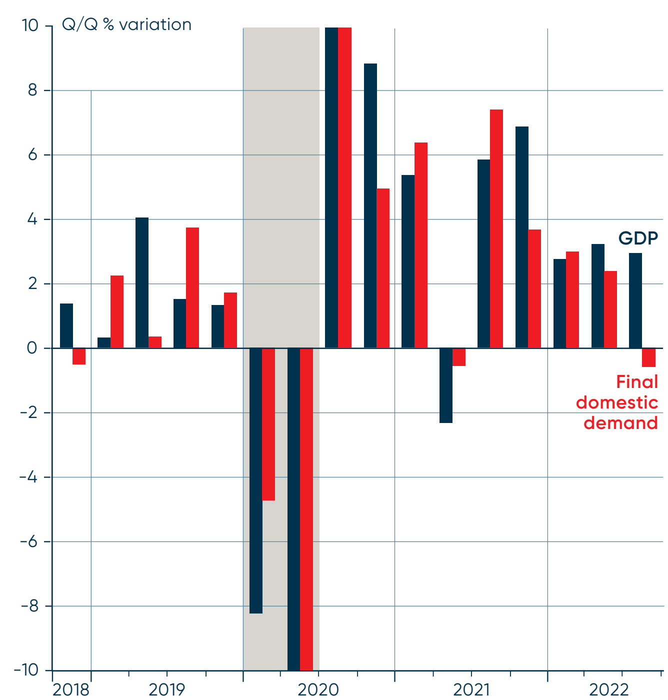
NBF Economics and Strategy (Data via refinitiv)

Canada

In Canada, the manœuvring for the landing of the economy after a period of overheating continues. So far, things are moving in the right direction for the Bank of Canada, which suggests that we are probably at the terminal rate in this extremely aggressive tightening cycle. Indeed, the labour market is showing signs of moderation, with employment showing a modest gain of 26K jobs over the past 6 months. Meanwhile, declining hiring intentions do not suggest near-term momentum. Third-quarter GDP growth was still solid, but due to a massive contribution from international trade, while final domestic demand recorded its weakest quarter since the start of the pandemic, with an annualized decline of 0.6%. For their part, inflationary pressures are much less acute and diffuse than earlier this year. With the Bank of Canada acting in haste and given the lag in the transmission of monetary policy, it is normal for observers to be nervous. Unfortunately, we will only know after the fact if it went too far. One thing is certain, we are already seeing a sharp slowdown in the housing market leading to extremely rapid home price deflation. In our view, it will not be necessary to keep interest rates at such high levels for long to calm inflation and we therefore expect the central bank to have to lower them in the second half of next year. Given the monetary tightening, we expect growth to be anemic at 0.7% in 2023, with the consumer being hit simultaneously by a loss of purchasing power, a negative wealth effect and an interest payment shock.

Canada: Q3 GDP jump masks demand weakness

Gross domestic product and domestic demand



NBF Economics and Strategy (Data via refinitiv)

Investment Strategy

The financial markets remained very choppy during the fourth quarter, with investor sentiment switching back and forth between pessimism and optimism. Indeed, after a difficult start to the quarter for both equities and bonds, an encouraging inflation report and a dovish speech by the chair of the Federal Reserve led to a dramatic market rebound, which, however, lost some steam toward the end of the period. Ultimately, quarterly performance was generally positive for both stocks and bonds, although 2022 remains a challenging year for a majority of investors.

On the one hand, the slowdown in inflation was an important source of market optimism during the quarter. Not only did gasoline prices continue to fall, but more importantly, the normalization of supply chains and the decline in several commodity prices allowed durable-goods inflation to decelerate significantly. In addition, the labour market remained strong and consumer spending held up; as such, economic activity in North America remained relatively healthy in recent months.

On the other hand, the resilience of the U.S. economy is complicating the Federal Reserve's task in its fight against inflationary pressures. Specifically, services inflation – closely tied to wage growth and thus to the strength of the labour market – still shows few signs of slowing on the horizon. Thus, the Fed brought its monetary policy into restrictive territory in November, a generally challenging environment for equities that also comes with elevated recession risks.

Going forward, a faster-than-expected slowdown in inflation would represent the most optimistic scenario, provided it prompts the central bank to stop its cycle of rate hikes sooner than anticipated and thus avoid a recession. That said, a significant risk factor remains excessive monetary tightening by a Federal reserve that cannot afford to underestimate the persistence of inflationary pressures yet again.

Under these circumstances, and following the strong stock market rebound in the first two months of Q4, we reduced for a third consecutive quarter the weight of equities within our tactical asset allocation at the end of November. This time, the shift was in favour of bonds, which have more attractive risk/return properties on a relative basis. As a result, our defensive positioning now shows an underweight in equities, a neutral allocation to bonds and an overweight in cash. Geographically, we continue to favour Canadian equities, which have clearly outperformed their peers in 2022, and U.S. equities, for their more defensive properties. However, we are less optimistic about emerging markets, for which the strength of the U.S. dollar, the slowdown in global economic activity, and the tightening of financial conditions represent major headwinds. Finally, the outlook for the EAFE region still appears weak, with economic growth likely to remain affected by energy disruptions.

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%	0.00%
	Fixed income (duration: 6.5 years)[1]	60% to 100%	70.0%	68.75%	0.8%
	Canadian equities	0% to 30%	8.0%	8.50%	-0.25%
	U.S. equities		8.0%	7.25%	-0.25%
	Foreign equities		4.0%	2.3%	-0.25%
	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%	0.0%
	Fixed income (duration: 6.5 years)[1]	45% to 80%	55.0%	54.5%	1.5%
	Canadian equities	20% to 45%	14.0%	14.5%	-0.5%
	U.S. equities		14.0%	12.5%	-0.5%
	Foreign equities		7.0%	4.0%	-0.5%
	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%	0.0%
	Fixed income (duration: 6.5 years)[1]	30% to 65%	40.0%	40.0%	1.5%
	Canadian equities	30% to 65%	18.0%	18.5%	-0.5%
	U.S. equities		18.0%	16.5%	-0.5%
	Foreign equities		9.0%	6.0%	-0.5%
	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%	0.0%
	Fixed income (duration: 6.5 years)[1]	20% to 45%	30.0%	30.0%	1.5%
	Canadian equities	40% to 75%	22.0%	22.5%	-0.5%
	U.S. equities		22.0%	20.5%	-0.5%
	Foreign equities		11.0%	8.0%	-0.5%
	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%	9.5%	0.0%
	Fixed income (duration: 6.5 years)[1]	0% to 30%	15.0%	15.0%	1.5%
	Canadian equities	55% to 100%	26.0%	26.5%	-0.5%
	U.S. equities		26.0%	24.5%	-0.5%
	Foreign equities		13.0%	9.5%	-0.5%
	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	-5.1	5.0	3.5	0.7
U.S.	-2.8	5.9	1.9	0.2
Inflation %				
Canada	0.7	3.4	6.8	2.8
U.S.	1.3	4.7	8.0	3.4

	December 2022		June 2023		December 2023	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-bills, 91-day)	4.25	4.35	4.20	4.55	3.25	3.35
10-year bond yields	2.80	3.45	2.70	3.20	2.70	2.95
30-year bond yields	2.80	3.45	2.70	3.25	2.70	3.10
Canadian Dollar	US $0.74		US $0.77		US $0.81	