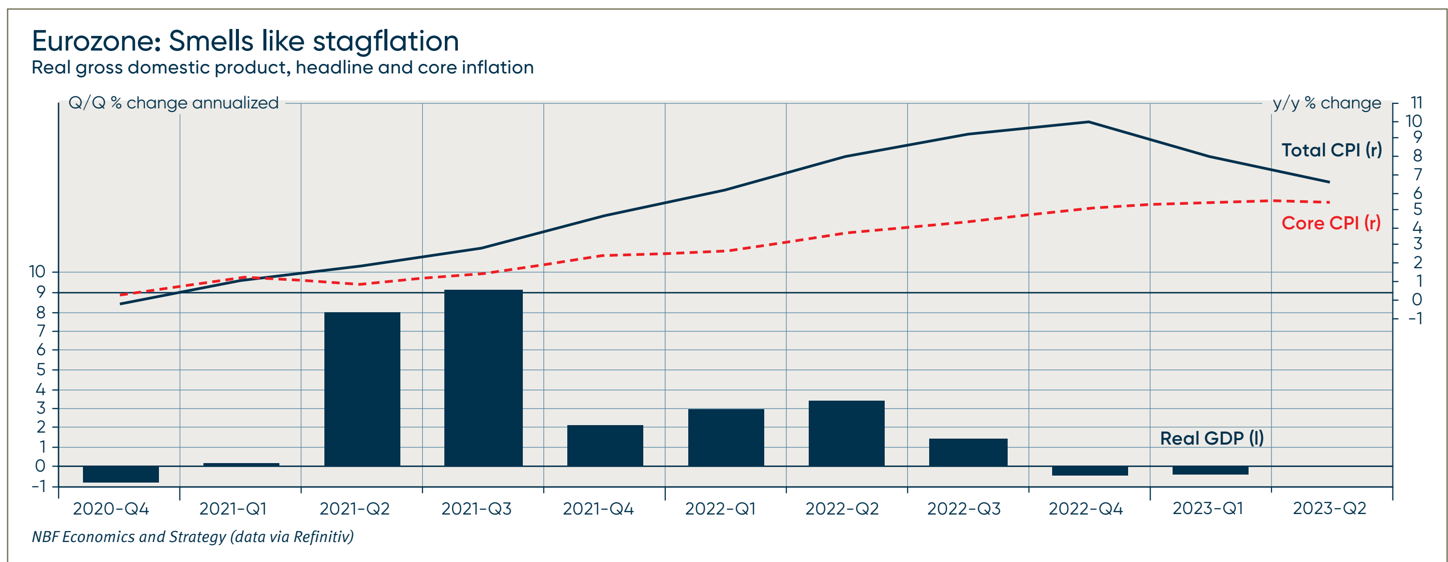
Summer 2023
Building your financial future

Investment Strategy

World

Once China had abandoned its zero-COVID policy, many thought that its economy would revitalize global growth in 2023. First-quarter data supported this notion, as Chinese GDP grew faster than expected. However, there are a few flaws in the strong recovery scenario: the figures were inflated by a positive base effect related to confinements in 2022, imports have not rallied, inflation has remained low, the manufacturing sector appears to be losing momentum, and the financial positions of provincial governments have deteriorated even further. And it is unlikely that the eurozone will save the day. Although the drop in natural gas prices due to a particularly mild winter was an unexpected boon for the currency zone, it did not prevent it from experiencing a slight economic contraction in Q4 and Q1. The outlook remains bleak. Household spending appears to be losing momentum, most certainly due to the fact that growth in household credit has slowed considerably in recent months. Given such a reversal in credit conditions, the European Central Bank (ECB) would normally have exercised extreme caution, but the eurozone's unemployment rate is still at a record low and core inflation has remained near its all-time high, effectively forcing the ECB to maintain an aggressive response. It appears increasingly likely that returning inflation to its target rate will mean an outright recession in the eurozone in the second half of 2023. This fragility, combined with the expected weakness in the U.S. and a slow rebound in China, supports our view that the global economy will remain sluggish over the next few quarters.



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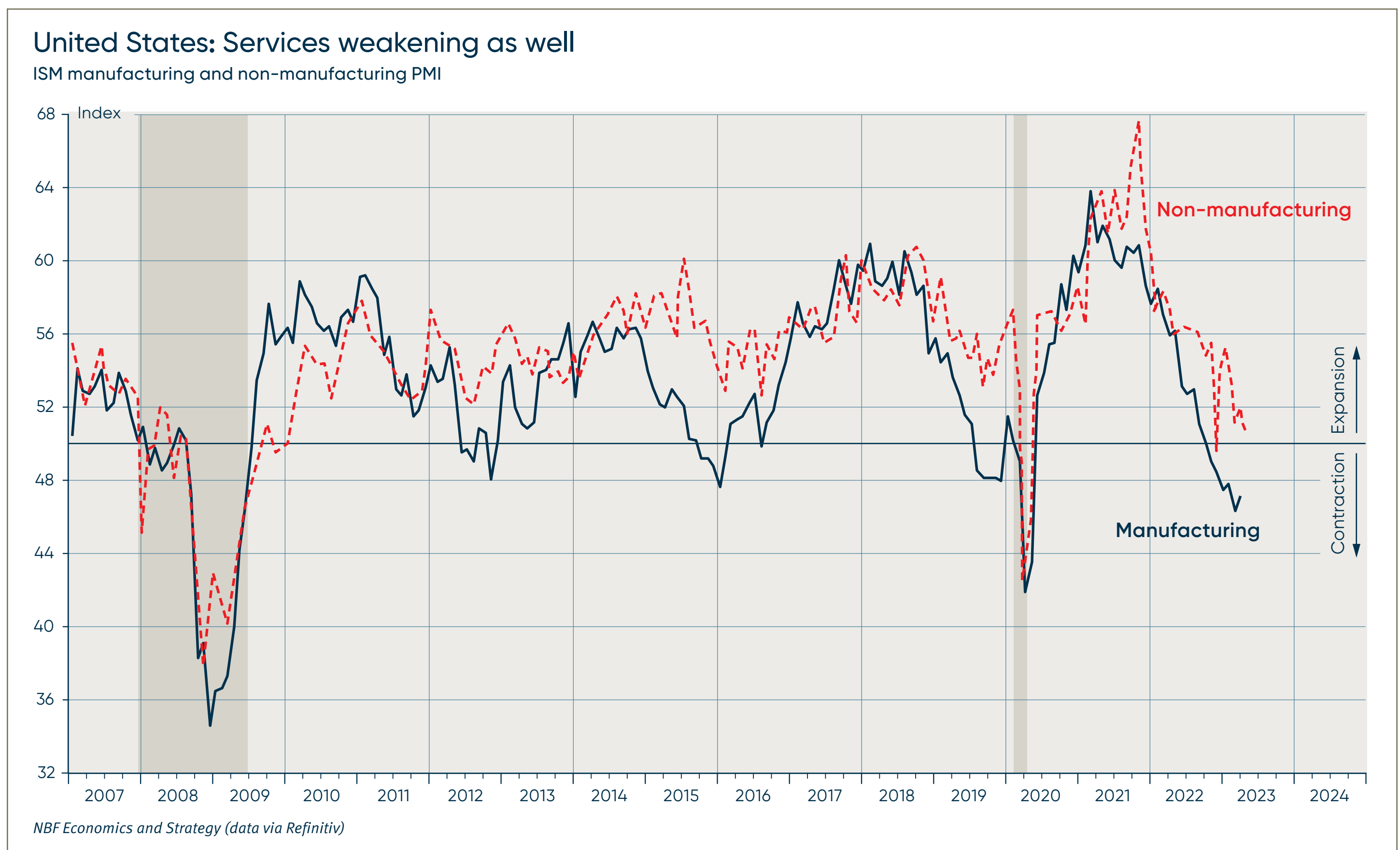
NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

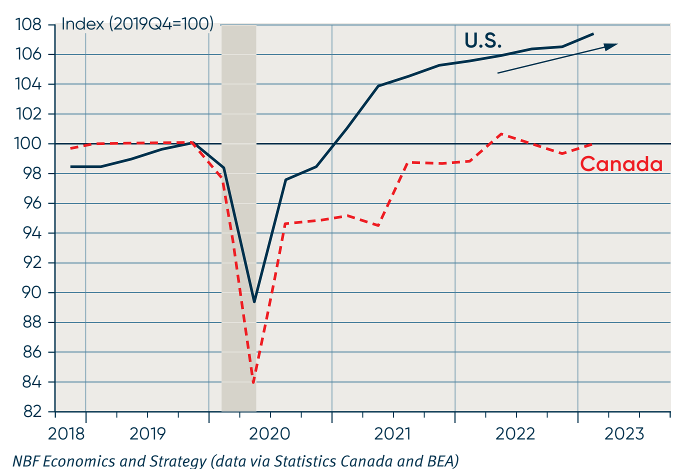
United States

In the United States, domestic demand was strong in the first quarter, but such a good performance does not change our view that growth will slow significantly by the end of the year as the aggressive monetary tightening of the past year works its way through the economy. The U.S. averted disaster with a deal to raise the debt ceiling, but several economic indicators are already pointing in that direction. While weakness in the manufacturing sector has been evident for several months, the service sector is now showing signs of a significant slowdown. In addition, uncertainty continues to surround the U.S. banking system, with three bank failures so far. Stress on small U.S. banks could re-emerge in a less favourable economic climate and a potentially higher federal funds rate. In addition, the Federal Reserve is unlikely to cut interest rates before the first half of 2024, aiming to cool domestic demand. While the labour market is starting to show signs of slowing, wage growth remains inconsistent with the central bank's inflation target. In our scenario, with monetary policy remaining very tight for such a long period, gross domestic product (GDP) will be put on a path that falls short of the consensus among economists. After a relatively buoyant first half of the year, we expect the U.S. economy to slip into a technical recession (three quarters of negative growth) starting in the fourth quarter of 2023. In this scenario, real GDP should grow by 1.4% in 2023 before declining 0.4% the following year.



Canada

Surprised by the resilience of the economy so far in 2023, the Bank of Canada raised its policy rate by another 25 basis points in June after a four-month hiatus, bringing the total tightening since March 2022 to 450 basis points. Was the Bank of Canada right to lose patience and raise the policy rate to levels not seen in more than two decades? It's true that inflation was surprisingly strong in April, raising concerns about its ability to bring it back to target without further tightening. There's also the fact that GDP is off to a strong start in 2023, with an eye-popping 5.7% increase in consumer spending in Q1. We knew that consumers had assets at their disposal, notably a higher savings rate than before the pandemic, and thus an accumulation of savings that seems to have been put to good use. But consumption may not be as strong as it appears given the explosive population growth. Canadian real consumption per capita has clearly lagged behind the U.S. over the past three quarters, showing that monetary policy transmission is in full swing. There is a risk that the central bank may not have waited long enough to see the full impact of the increases it has already made. After a solid start to the year, the labour market weakened in May, posting a first contraction in nine months. The details of the report weren't much better, with full-time employment contracting for the second month in a row, a first in two years. In our view, it was only a matter of time before a reversal occurred after a hiring spree. According to the national accounts, corporate profits and investment fell for the third consecutive quarter in Q1, which usually does not bode well for hiring in the following months. What's more, 70% of SMEs said in May that wages were causing difficulties for their business, a record proportion since the data was first compiled in 2009. The profitability challenge will make businesses much more cautious in the months ahead. We still expect the Canadian economy to be lethargic over the next year, leading to anemic economic growth rates of 1.3% in 2023 and 0% in 2024.



Investment Strategy

A relative calm settled over the markets in the second quarter of 2023, offering investors some respite after a particularly hectic start to the year. Indeed, aside from the excellent performance of the U.S. technology giants, most asset classes ended the period little changed, with bonds slightly underperforming equities.

On the economic front, data continues to send out often contradictory signals, underlining the uniqueness of the current cycle. Specifically, the weakness of indicators linked to the manufacturing sector and the significant contraction in the price of several commodities point to a deterioration in economic activity. However, the service sector remains resilient thanks to relatively upbeat consumers, who are supported by excess savings and a strong labour market. The end result is an economy that, for the time being, continues to show weak but positive growth, putting off fears of recession until later.

However, the flip side of a stronger-than-expected economy is the recent persistence of inflation, much to the dismay of central banks. The Bank of Canada is a case in point; after announcing a pause in its monetary-tightening cycle in January, it finally decided to raise its policy rate again in June, taking the markets by surprise. Clearly, the prospects of rate cuts before the end of the year seem increasingly unlikely, as the return to more accommodative policies will have to wait.

In the end, even if we can't rule out an ideal scenario in which monetary tightening succeeds in slowing inflation further without harming economic activity, the balance of risks still prompts us to err on the side of caution. After all, even the Federal Reserve is projecting that a material rise in the unemployment rate will be needed to bring inflation back to target. What's more, several early signs of an economic slowdown are pointing towards the second half of the year, when the cumulative impact of previous rate hikes should start to be felt more acutely.

Against this backdrop, we maintained our tactical asset allocation unchanged over the quarter, as we believe equity markets are already largely discounting the more optimistic scenarios. As a result, our defensive positioning remains underweight equities, slightly overweight bonds, and overweight cash. Geographically, we continue to favour Canada over emerging markets, while maintaining a neutral allocation to the United States and the EAFE region.

MODEL PORTFOLIOS

Income Portfolio

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.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	5.0%	8.25%	0.0%
Fixed income (duration: 7.25 years)[1]	60% to 100%	70.0%	70.50%	0.25%
Canadian equities	0% to 30%	8.0%	7.50%	-0.25%
U.S. equities		8.0%	6.50%	0.0%
Foreign equities		4.0%	2.25%	0.0%
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.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	5.0%	9.5%	0.0%
Fixed income (duration: 7.25 years)[1]	45% to 80%	55.0%	57.0%	0.5%
Canadian equities	20% to 45%	14.0%	13.0%	-0.5%
U.S. equities		14.0%	11.5%	0.0%
Foreign equities		7.0%	4.0%	0.0%
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.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	5.0%	9.0%	0.0%
Fixed income (duration: 7.25 years)[1]	30% to 65%	40.0%	43.0%	0.5%
Canadian equities	30% to 65%	18.0%	17.0%	-0.5%
U.S. equities		18.0%	15.5%	0.0%
Foreign equities		9.0%	5.5%	0.0%
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.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 25%	5.0%	9.0%	0.0%
Fixed income (duration: 7.25 years)[1]	20% to 45%	30.0%	33.0%	0.5%
Canadian equities	40% to 75%	22.0%	21.0%	-0.5%
U.S. equities		22.0%	19.5%	0.0%
Foreign equities		11.0%	7.5%	0.0%
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.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 30%	5.0%	9.5%	0.0%
Fixed income (duration: 7.25 years)[1]	0% to 30%	15.0%	19.5%	0.5%
Canadian equities	55% to 100%	26.0%	24.5%	-0.5%
U.S. equities		26.0%	23.0%	0.0%
Foreign equities		13.0%	8.5%	0.0%
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

	2021	2022	2023 (Forecast)	2024 (Forecast)
Gross Domestic Product %				
Canada	5.0	3.4	1.3	0.0
U.S.	5.9	2.1	1.4	-0.4
Inflation %				
Canada	3.4	6.8	3.6	2.3
U.S.	4.7	8.0	3.8	2.0

	June 2023		December 2023		December 2024	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-bills, 91-day)	4.95	5.25	4.85	5.30	3.55	3.90
10-year bond yields	3.40	3.85	3.25	3.70	3.00	3.25
30-year bond yields	3.30	3.95	3.20	3.80	3.00	3.40
Canadian Dollar	US $0.74		US $0.72		US $0.75	

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