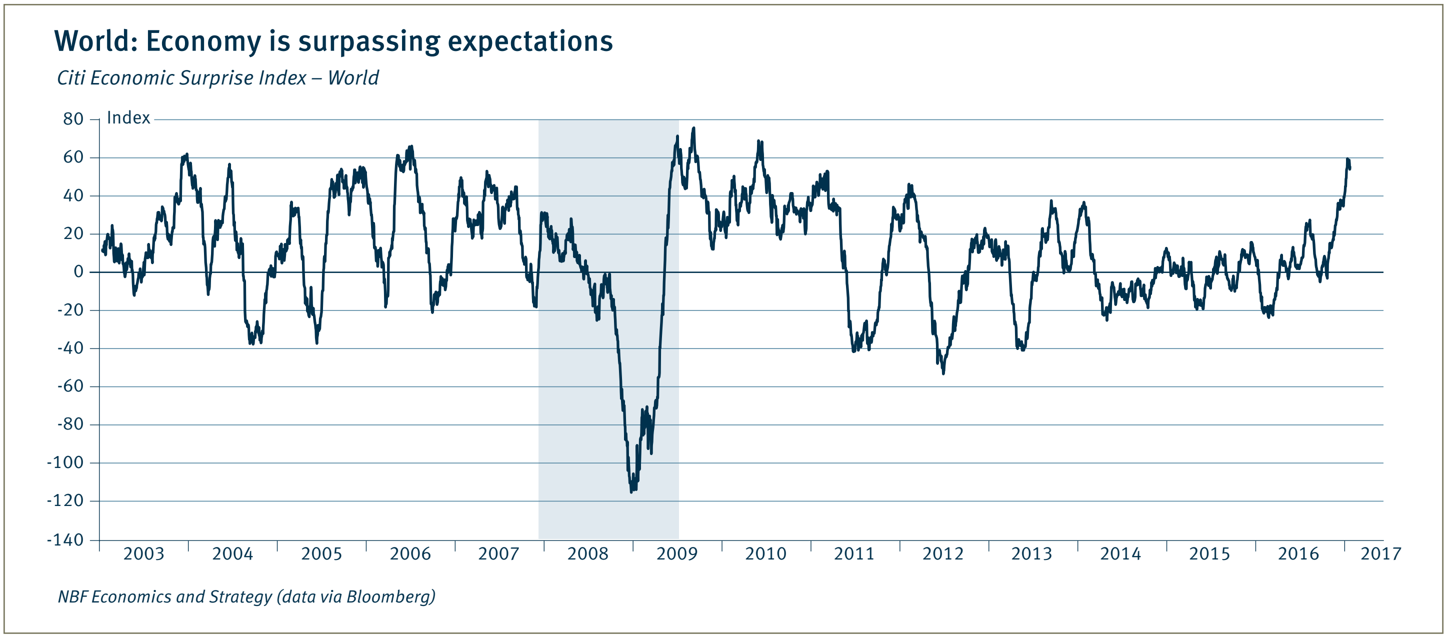
March 2017
Building your financial future

Investment Strategy

Global Economy

The world economy is improving with the Global Purchasing Managers' Index increasing in the fourth quarter to the highest in over a year. And after stagnating for much of the year, trade volumes rose to an all-time high in November, helping world industrial production grow in Q4 at the fastest pace in two years. With all of the main economies showing better-than-expected economic data in recent months, global GDP is on track to expand by 3.3% or more in 2017. The rise of trade protectionism represents the biggest risk to the outlook.



In this issue

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

United States

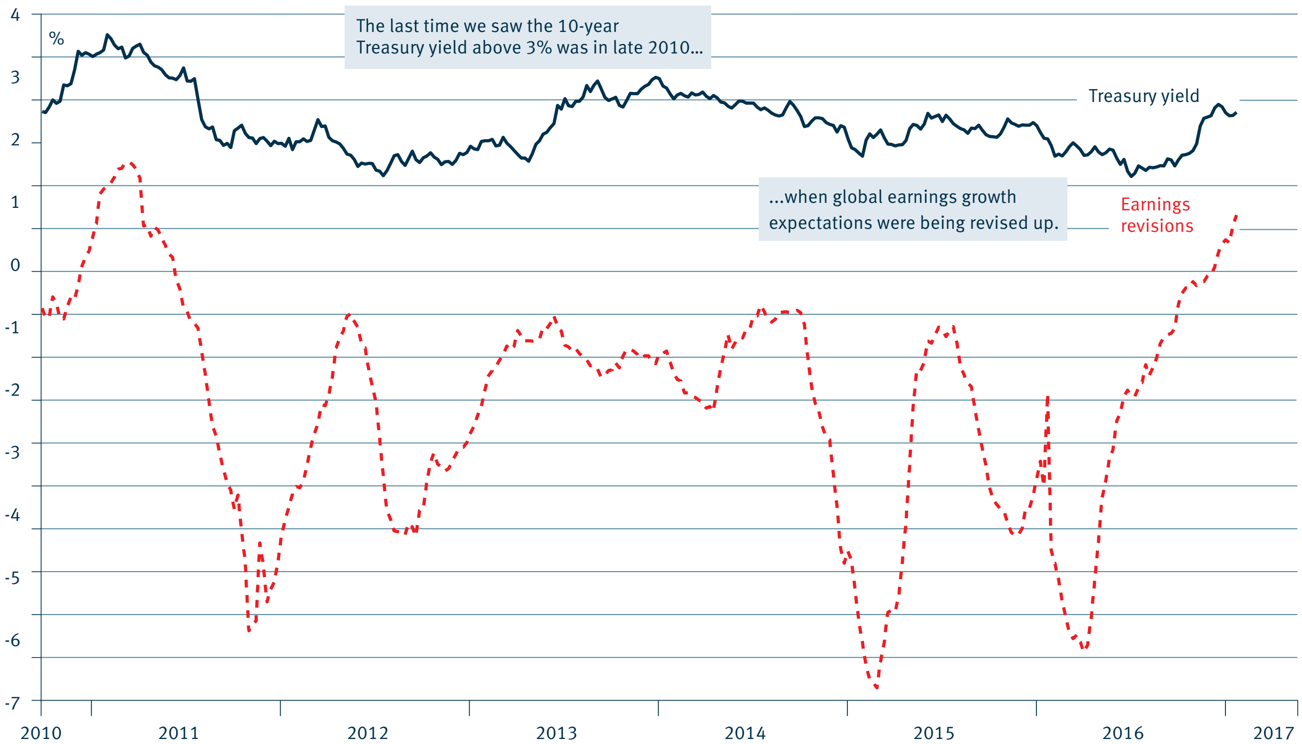
U.S. GDP growth should accelerate to more than 2% this year on the back of strong labour markets (unemployment rate below 5%) and fiscal stimulus enacted by the new leadership. Such above-potential growth should allow inflation to hit the Federal Reserve's target for the first time in five years. Fortunately, prices are unlikely to get out of control because of spare capacity, demographics and the introduction of new technologies. This means that the rise in interest rates should be moderate. The longer-term U.S. outlook for both growth and inflation is less clear given the protectionist measures being considered by the Trump administration.

Financial Markets

The MSCI AC, the benchmark for global equities, continues to make new highs. All the main regions of the world are up in 2017, with emerging markets showing an especially brisk gain. At this writing, the MSCI AC is trading at almost 16 times forward earnings, the highest valuation at this point in a new year since 2004. With a multiple that high, the market driver needs to be earnings growth rather than P/E expansion. The good news is that global economic momentum seems to be returning, with a pretty dramatic effect on profit expectations. Global earnings revisions have turned positive for the first time in six years. The last time this happened, the 10-year U.S. Treasury yield moved above 3%. In addition to strong global economic momentum, the optimism about earnings is supported by the largest upside economic surprises in almost seven years. Though the current cyclical backdrop remains encouraging for equities, the outlook has been blurred by Washington.

World: Upward earnings revisions for the first time in 6 years

Three-month change in 12-month forward earnings growth for the MSCI AC vs. yield on 10-year U.S. Treasuries



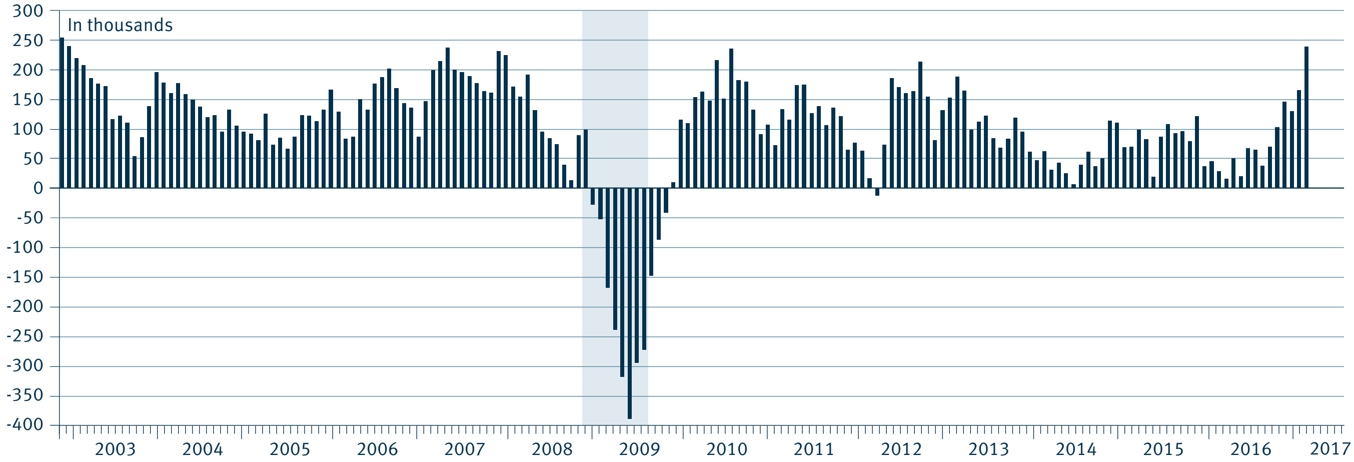
NBF Economics and Strategy (data via Datastream)

Canada

The Canadian economy continues to surprise on the upside as real GDP posted its fifth increase in the last six months. The economy continues to find support thanks to resilience in the services sector and a pickup in exports. The labour market has generated a massive surge of 239,000 jobs in the last six-month period, the strongest performance in 15 years. Job creation continues to underpin demand for housing. The Canadian economy should expand 1.9% in 2017, up from 1.3% in 2016. Possible imposition of protectionist trade policies in the U.S. remains the main risk for Canada.

Canada: The best job creation in 15 years

Change in total employment – 6-month change



NBF Economics and Strategy (data via Statistics Canada)

Investment Strategy

Overall, financial markets have taken the U.S. election results in stride as the newly elected president's policies are interpreted as pro-growth and good for corporate bottom lines. While we agree that the three-pronged approach of deregulation, tax reduction and infrastructure spending should act as a tailwind for the U.S. economy, we are left wondering about the exact timing at which they will be implemented. For now, 2018 seems to be the more likely scenario. We must also consider that announcements emanating from the White House are not all positive. The President's hostility towards trade deals and his willingness to renegotiate them as well as immigration roadblocks have the potential to cancel a large part of the effects from the other policies we discussed above. Consequently, we suggest a neutral position in U.S. equities until we get a clearer picture of the administration's plans and their potential impact.

In Canada, employment has continually surprised on the upside as the economy slowly rebounds from the oil shock in 2014. However, uncertainty remains high given policymakers have to contend with potential NAFTA renegotiations. While we think logic should eventually prevail, the potential damage from failure on that front prompts us to suggest a neutral position in Canadian equity markets for the time being.

For fixed income products, we think they are at risk, as yields will rise in light of a pickup in inflation. Energy prices are now up materially from a year ago and labour markets are now strong enough that wage growth will contribute to the inflationary picture. The Fed already hiked in December of 2016 and further tightening is planned in the next quarters. In light of that environment, we suggest investing in shorter-term securities or products offering better protection in a rising yield environment such as non-traditional fixed income. If you have to invest in longer durations, we suggest investments with an inflation tilt. As we do not expect a recession in the coming year, we think products with higher credit risk will outperform government bonds.

The Fed's monetary policy divergence with its major counterparts should push the U.S. dollar up. The currency would also experience tailwinds should the president implement his protectionist policies. Consequently, the Canadian dollar is likely to submit to those pressures, as it seems that in recent months, the pair's performance has been more influenced by greenback strength than any other factor, such as energy price swings. Given this, we suggest keeping a large portion of investments in un-hedged USD for the time being.

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%	9.5%	1.0%
	Fixed income (duration: 5.25 years)[1]	60% to 100%	70.0%	65.0%	0.0%
	Canadian equities	0% to 30%	7.5%	7.5%	-0.5%
	U.S. equities		7.5%	8.0%	-0.5%
	Foreign equities		5.0%	5.0%	0.0%
	Alternative investments[2]	0% to 10%	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%	1.0%
	Fixed income (duration: 5.25 years)[1]	45% to 80%	55.0%	50.0%	0.0%
	Canadian equities	20% to 45%	14.0%	14.0%	-0.5%
	U.S. equities		14.0%	14.5%	-0.5%
	Foreign equities		7.0%	7.0%	0.0%
	Alternative investments[2]	0% to 15%	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%	9.5%	1.0%
	Fixed income (duration: 5.25 years)[1]	30% to 65%	40.0%	35.0%	0.0%
	Canadian equities	30% to 65%	17.5%	17.5%	-0.5%
	U.S. equities		17.5%	18.0%	-0.5%
	Foreign equities		10.0%	10.0%	0.0%
	Alternative investments[2]	0% to 20%	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%	0.0%	5.0%	1.0%
	Fixed income (duration: 5.25 years)[1]	25% to 45%	35.0%	29.5%	0.0%
	Canadian equities	40% to 75%	20.0%	20.0%	-0.5%
	U.S. equities		20.0%	20.5%	-0.5%
	Foreign equities		15.0%	15.0%	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.	Cash equivalents	0% to 30%	0.0%	6.0%	1.0%
	Fixed income (duration: 5.25 years)[1]	0% to 30%	20.0%	13.5%	0.0%
	Canadian equities	55% to 100%	22.5%	22.5%	-0.5%
	U.S. equities		22.5%	23.0%	-0.5%
	Foreign equities		20.0%	20.0%	0.0%
	Alternative investments[2]	0% to 30%	15.0%	15.0%	0.0%

1 Dex Universe Index
2 Includes hedge funds, global real estate and infrastructure, and commodities.

FORECAST

			Forecast	
	2015	2016	2017	2018
Gross Domestic Product %				
Canada	0.9	1.3	1.9	1.7
U.S.	2.6	1.6	2.2	2.4
Inflation %				
Canada	1.1	1.4	1.8	2.0
U.S.	0.1	1.3	2.2	2.2

	March 2017		December 2017		December 2018	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-Bills, 91-Day)	0.48	0.58	0.63	1.05	1.37	1.93
10-year bond yields	1.91	2.62	2.14	3.03	2.80	3.32
30-year bond yields	2.49	3.16	2.62	3.46	3.13	3.68
Canadian dollar	US$0.74		US$0.73		US$0.75	