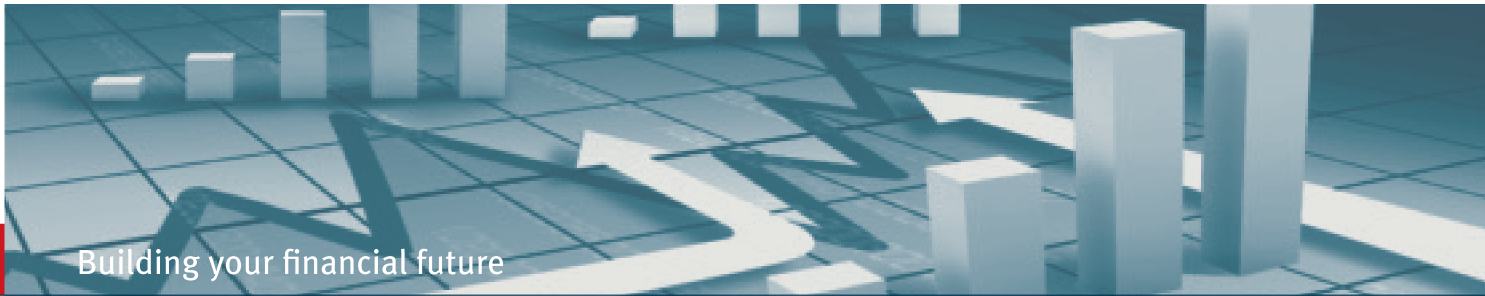


Building your financial future

Investment Strategy

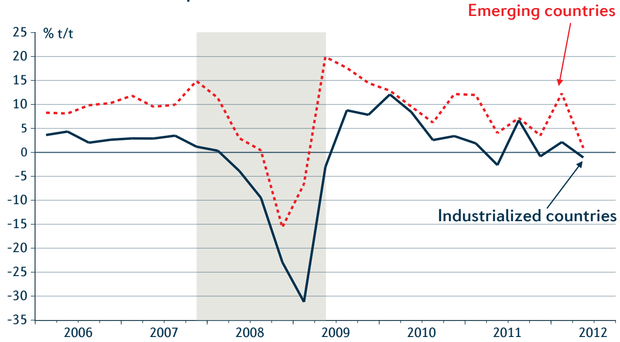
September 2012

Around the World

Global economy

Investor fears have subsided recently, notably with regard to the euro zone. The European Central Bank has managed to ease financial pressures on the strained governments of the monetary union. However, much remains to be done to equip the zone to get out of the woods and stay out. Though the Q2 GDP contraction wasn't as bad as feared, manufacturing indicators for Q3 signal further deterioration of the euro-zone economy. Meanwhile, the European recession is being felt in the rest of the world. In the emerging economies, industrial production growth cooled in Q2 to the slowest since the recession of 2008-2009. Fortunately, central banks and governments around the globe are responding with increased monetary and/or fiscal stimulus. China recently announced an increase in government infrastructure spending over the next four years in a program that is forecast to add 2% to Chinese GDP over the period. Uncertainty notwithstanding, the forceful interventions of policymakers since the end of July are likely to mitigate the drag from European austerity, a drag augmented by the oil price rise that has resulted from heightened geopolitical risk in the Middle East. We expect global GDP to continue expanding at just above 3% in 2013.

Slow growth worldwide
World industrial output



NBF Economy & Strategy (data via Datastream)

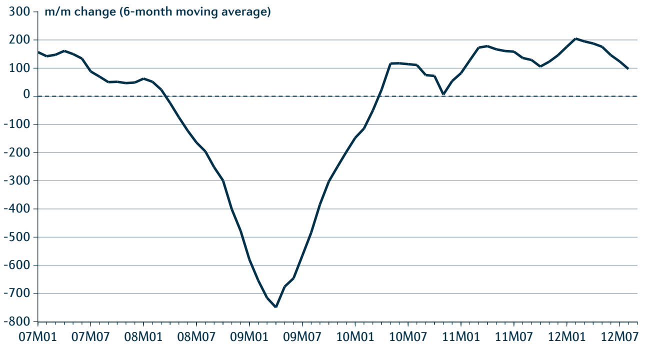
In this issue

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

United States

Manufacturing indicators, including weak orders, suggest that sub-2% U.S. growth continued in Q3. For subsequent quarters there is little relief in sight. Uncertainty about whether the U.S. will jump off its self-imposed fiscal cliff will crimp the economy through the rest of the year, and the congress elected in November may be unable to act in time to save Q1 from the effect of the automatic tax hikes and spending cuts that are now on the books for January. This uncertainty has braked hiring significantly. Payrolls have gained fewer than 100,000 net jobs per month on average since last spring, the worst showing in a year. Though this is far from a contraction, it is not enough to lower the unemployment rate significantly. The U.S. Federal Reserve responded in September by launching its third campaign of quantitative easing (QE3). The aim is to quicken the economic recovery, particularly in the housing market – which continues to pick up – and through wealth effects from both property values and the stock market. Our current forecast is for a U.S. expansion of 1.7% in 2013.

United States: A disappointing pace of hiring
Payroll



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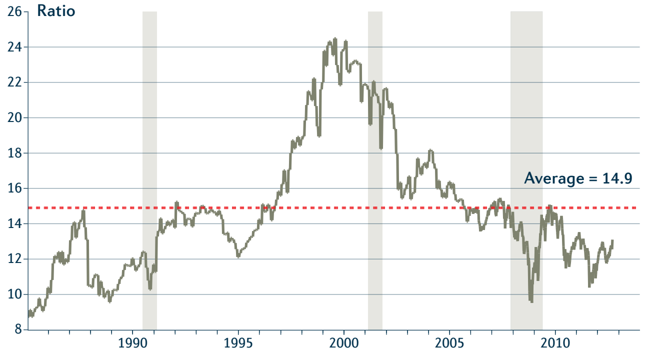
Financial Markets

Global equity markets have regained ground in recent weeks after a significant correction in Q2. The MSCI All Country Index is up 3.2% so far in Q3, with all regional MSCI Indexes in the black. The European and BRIC markets have posted the largest gains as they recover from sharp pullbacks in Q2. Central banks are certainly doing their part to alleviate stress in financial markets. On September 13, the U.S. Federal Reserve delivered a double dose of extra monetary stimulus.

First, it extended by six months ("at least through mid-2015") the period during which it expects to keep its target fed funds rate at zero. In a second move, perhaps more eagerly anticipated by markets, it announced a new asset-purchase program, i.e., a third campaign of quantitative easing (QE3). The Fed said it will buy $40 billion a month in agency mortgage backed securities and did not specify an end date for the operation. Meanwhile, Operation Twist will continue as announced in June 2011. Thus with September's new measures, the Fed's holdings of long-term securities will expand at $85 billion a month through the rest of the year. The Federal Reserve is hoping that these moves will boost equity markets as well as support the economy. Despite two rounds of quantitative easing, the S&P 500 price/earnings ratio remains below its historical average.

Stock market: Evaluations from a long-term perspective
S&P 500 Index P/E ratio (based on forward earnings)



NBF Economy & Strategy (data via Datastream)

Canada

The Canadian economy expanded at 1.8% annually in the second quarter. This was a bit better than the consensus expectation, but the Q2 report showed softness in the details. Much of the growth was in inventory accumulation, a negative for Q3 production. Further down the road, domestic demand is set to remain soft. Consumer spending will be curbed by further moderation in the labour and housing markets, and credit growth will be slow. With Ottawa firm in its balanced-budget goal, government spending will also contribute little to growth. The outlook for business investment is a bit better because corporations have plentiful cash on hand and borrowing rates are low, but whether these pluses translate into green lights for capital outlays will depend on the economic outlook at home and abroad, and neither front looks very enticing at the moment. Since our main export market seems destined for sub-2% growth in the next little while, trade is unlikely to provide much offset to the softness of domestic demand. Though Q2 came in exactly as the Bank of Canada had estimated, a downward revision to the prior quarter means that the output gap may not close next year. Consequently, we would not be surprised to see our central bank refrain from raising interest rates in the next 12 months. The housing market shows signs of deceleration, the Canadian dollar is very strong and growth remains feeble in the economies of many of our trading partners.

Investment strategy

Equity markets managed to put in a good performance in recent months, as fears related to the European sovereign debt crisis, the slowdown in China and the soft patch in the U.S. economy have been largely offset by the setting up of new monetary easing measures.

Because of the Spanish banking crisis and pressures on sovereign financing rates, the European Central Bank (ECB) has staked everything in July by announcing that the euro was "irrevocable" and that all would be done to preserve it. Markets had to wait until September to see the ECB move from words to action, but the terms of its new outright monetary purchases in the secondary market were clearly up to expectations. In parallel, the Fed, which remains concerned about the slow progress of the labour market, committed to increasing its purchases of mortgage backed securities and to maintaining the level of the fed funds rate to an exceptionally low level at least through mid-2015 to strengthen the economy.

In our opinion, this new phase of monetary easing, concurrent on both sides of the Atlantic, should be sufficient to support the stock market rally in the coming months. In fact, recent episodes of QE have shown that even if markets are positioned in expectations of future policies, the announcement and details of these policies lead to additional market gains in subsequent quarters. It must also be said that the reversal of several economic indicators shows that the feared pessimistic scenarios did not materialize. With the downward adjustment of growth forecasts, the surprise index is about to become positive. In addition, the U.S. housing sector seems to have finally taken off, an important prerequisite for sustained economic growth.

Due to this improvement, we have adjusted the portfolio risk upward in early September, from a slightly defensive stance to a level that is a little more aggressive. Thus, cash was brought down to neutral. In theory, the Fed's policies should aim at anchoring interest rates around the current low levels. In practice, however, the narrowing of European sovereign spreads and investors' search for yield could cause the demand for safe-haven assets to slow down, exerting upward pressure on the yields of government securities. Therefore, bonds should now be weighted in some, while maintaining a clear preference for corporate credit. We increased the equity weighting favouring the Canadian market. The latter, which has experienced a significant relative underperformance over the last year, should benefit from a more cyclical sector rotation and the positive effect of quantitative easing policies on commodity prices.

However, we remain reluctant to run at full speed while several concerns remain to be addressed. The ECB measures have significantly limited the risk of a break-up of the euro, but they don't solve the problems of excessive debt in several European countries. Moreover, the coming U.S. elections in November will surely turn the spotlight on the uncertainty surrounding the U.S. financial abyss.

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 very low.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	10.0%	11.0%	-1.0%
Fixed-income (duration: 5.9 years)[1]	60% to 100%	70.0%	69.0%	-1.0%
Canadian equities		10.0%	11.5%	2.0%
U.S. equities	0% to 30%	5.0%	5.5%	0.0%
Foreign equities		5.0%	3.0%	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 15%	5.0%	5.5%	-1.5%
Fixed-income (duration: 5.9 years)[1]	50% to 80%	60.0%	59.5%	-0.5%
Canadian equities		20.0%	22.0%	2.5%
U.S. equities	20% to 45%	7.5%	8.0%	-0.5%
Foreign equities		7.5%	5.0%	0.0%

Balanced Portfolio

Investor Profile: You give equal weight to income and capital growth. You can tolerate moderate volatility to ensure the growth of your capital, but you prefer having a portfolio with a significant exposure to fixed-income securities for reasons of stability. Your tolerance for risk is average.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	5.0%	5.5%	-1.0%
Fixed-income (duration: 5.9 years)[1]	30% to 65%	45.0%	44.0%	-1.0%
Canadian equities		25.0%	27.0%	3.0%
U.S. equities	30% to 65%	10.0%	11.0%	-0.5%
Foreign equities		10.0%	7.5%	-0.5%
Alternative investments [2]	0% to 15%	5.0%	5.0%	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%	0.0%	1.0%	-1.0%
Fixed-income (duration: 5.9 years)[1]	25% to 45%	35.0%	34.0%	-1.0%
Canadian equities		25.0%	27.5%	3.0%
U.S. equities	40% to 75%	15.0%	16.0%	-1.0%
Foreign equities		15.0%	11.5%	0.0%
Alternative investments [2]	0% to 20%	10.0%	10.0%	0.0%

Maximum Growth

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 very high.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 30%	0.0%	0.0%	-1.0%
Fixed-income (duration: 5.9 years)[1]	0% to 30%	20.0%	19.5%	-0.5%
Canadian equities		25.0%	27.5%	3.0%
U.S. equities	55% to 100%	20.0%	21.5%	-1.0%
Foreign equities		20.0%	16.5%	-0.5%
Alternative investments [2]	0% to 25%	15.0%	15.0%	0.0%

1) Includes conventional and real return bonds. Benchmark = 75% DEX Universe Index, 25% SC RRB Index.
2) Includes hedge funds and real estate. Benchmark = 50% Tremont Hedge Fund Index, 50% S&P TSX Cap REIT Index.

Forecast

	2010	2011	2012 (Forecast)	2013 (Forecast)
Gross Domestic Product %				
Canada	3.2	2.4	1.9	1.6
U.S.	2.4	1.8	2.2	1.7
Inflation %				
Canada	1.8	2.9	1.7	2.1
U.S.	1.6	3.1	1.9	1.5

	September 2012		December 2012		December 2013	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-Bills, 91-Day)	1,00	0.11	0.98	0.08	1.17	0.14
10-year bond yields	1.85	1.76	1.89	1.72	2.54	2.37
30-year bond yields	2.42	2.95	2.51	2.83	2.93	3.28
Canadian dollar	U.S.$1.02		U.S.$1.01		U.S.$1.04	