NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

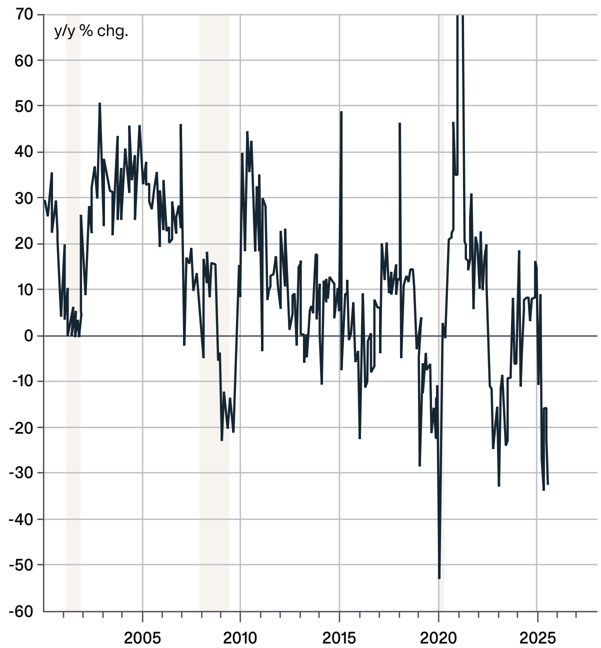
Investment Strategy

World

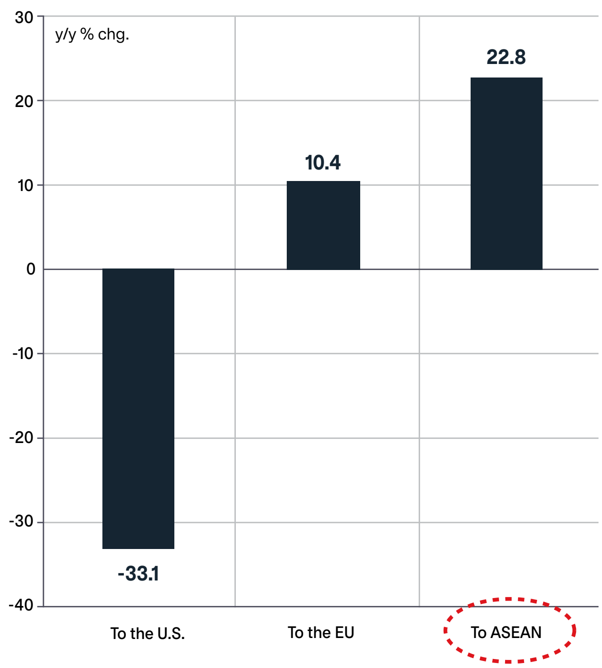
One of the ironies associated with the U.S. administration's implementation of protectionist policies is that, rather than causing an immediate slowdown in the global economy, it has instead led to a temporary increase in trade and, by extension, industrial production, with demand being stimulated by the frontloading of orders by companies wishing to avoid surcharges. The logical consequence of this process was that demand would inevitably fall once the tariffs were in place. To some extent, this is what happened in the second quarter of the year. And although the decline in activity was less severe than expected, it was nevertheless enough to hurt the most export-dependent economies. Unsurprisingly, China tops this list, as its efforts to find new export markets were not enough to offset a sharp decline in shipments to the United States. Given its exposure to foreign trade, we had every reason to expect equally disappointing economic results in the eurozone, but the reality was not as bleak as expected. Growth slowed in the second quarter—Germany even recorded a contraction—but remained positive. More than the economy, it was politics that caused some concern, with another French government falling after failing to pass a budget aimed at reducing the deficit. We would still describe our growth outlook for the eurozone as moderately optimistic. After all, inflation in the single currency area has been brought back to the European Central Bank's target, and this process has not led to higher unemployment. The easing of inflationary pressures has also allowed the central bank to significantly reduce its key interest rate, and the effects of this easing will continue to feed through to the economy over the coming months, partially offsetting the impacts of the trade war. While we are aware that uncertainty remains high and that some regions of the world are still operating below their potential, and may continue to do so for some time, we nevertheless believe that the global economy has weathered the shock of protectionist policies better than expected. While we do not expect exceptional growth over the next 18 months, we are increasingly confident that the economic expansion will continue in the medium term. Our baseline scenario forecasts identical global GDP growth of 3.1% in 2025 and 2026.

China: Rerouting of exports can't fully compensate for U.S. tariffs

Exports to the United States



Exports to selected countries/country groups



NBC Economics and Strategy (data via Bloomberg)

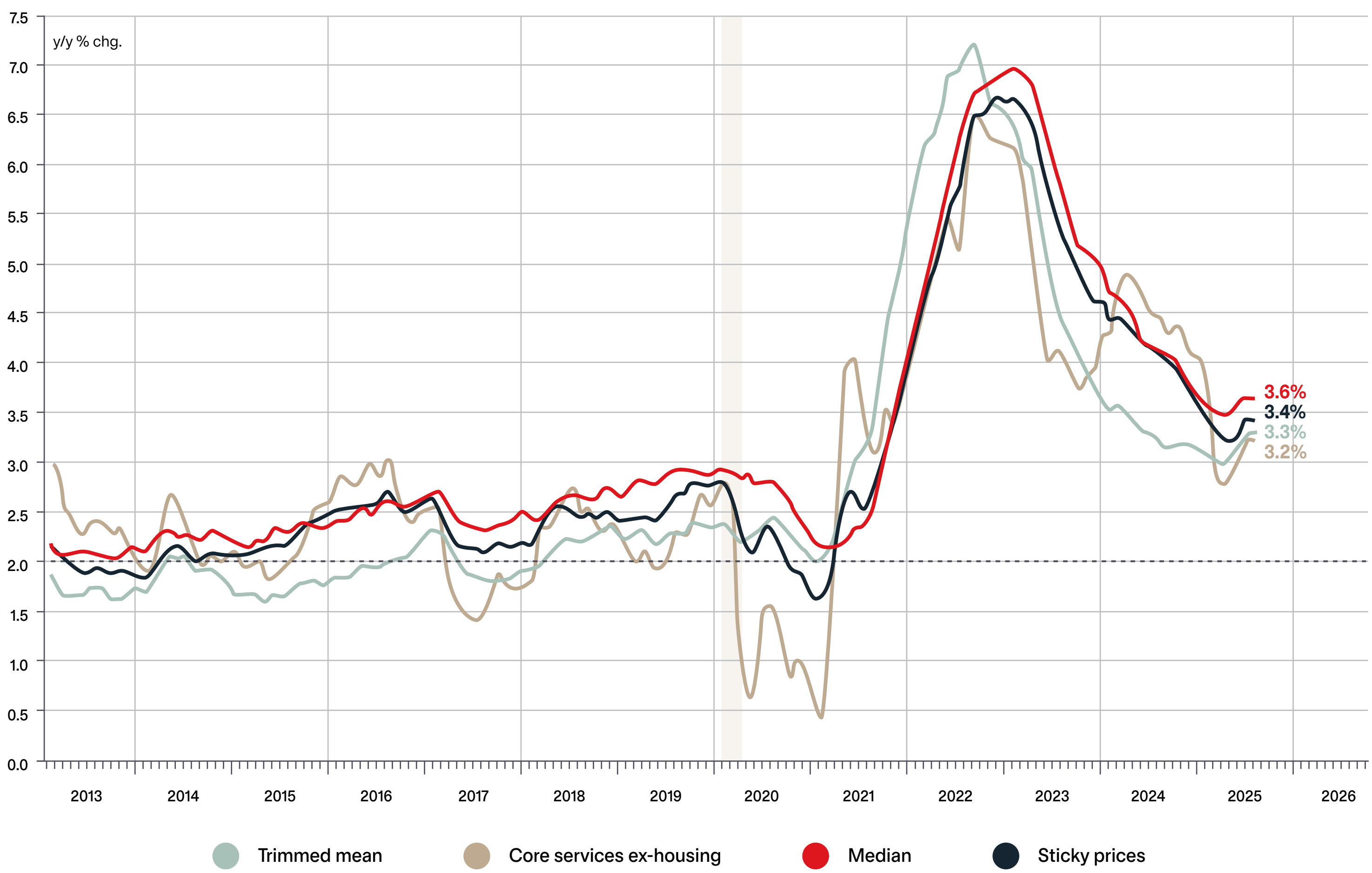
In this issue

United States

The slowdown in the labour market has certainly been the topic that has attracted the most attention in recent weeks in the economic sphere. Not only was nonfarm payroll growth well below expectations in July and August, but revisions to historical data revealed much weaker job creation than initially announced. Without wishing to downplay the recent slowdown, it is nevertheless useful to put it into context. After all, a decline in job creation was inevitable given the marked slowdown in population growth and, more specifically, the decline in the foreign-born population. The question, then, is whether job creation has slowed too much, and there are reasons to believe that this may be the case. This is why the Fed has resumed its cycle of monetary easing. Although we share the concerns of policymakers regarding employment, we continue to believe that the downward trajectory in benchmark interest rates currently anticipated by the markets is too ambitious. This is because, with the exception of employment, most of the economic data published recently have exceeded economists' expectations. The behaviour of the stock markets and, more generally, the looseness of financial conditions do not indicate an urgent need for easing either. Above all, however, it is the inflation situation that makes us doubt the Fed's ability to offer as much relief as the market would like. It is true that, on an annual basis, the CPI is significantly lower than it was just a few months ago, but we do not believe that this comparison is valid. Excluding the pandemic period, core inflation remains at its highest level since the mid-1990s. Other measures of underlying price pressure tracked by economists convey the same message: not only is core inflation too high, but it has been moving in the wrong direction in recent months. We therefore believe it is too early for the Fed to let its guard down, especially in a context where policies implemented in Washington risk putting further upward pressure on prices. Against this backdrop, we expect GDP growth to slow, approaching stagnation by the end of the year, before gradually picking up speed as the effects of the One Big Beautiful Bill begin to feed through to the economy. The unemployment rate is expected to rise in the coming months, although not enough to cause a significant drop in inflation, before resuming its downward trajectory from Q2 2026. In our baseline scenario, this translates into identical growth rates of 2.0% in 2025 and 2026.

U.S.: Core inflation measures have stopped easing

CPI inflation, selected core measures



NBC Economics and Strategy (data via Bloomberg)

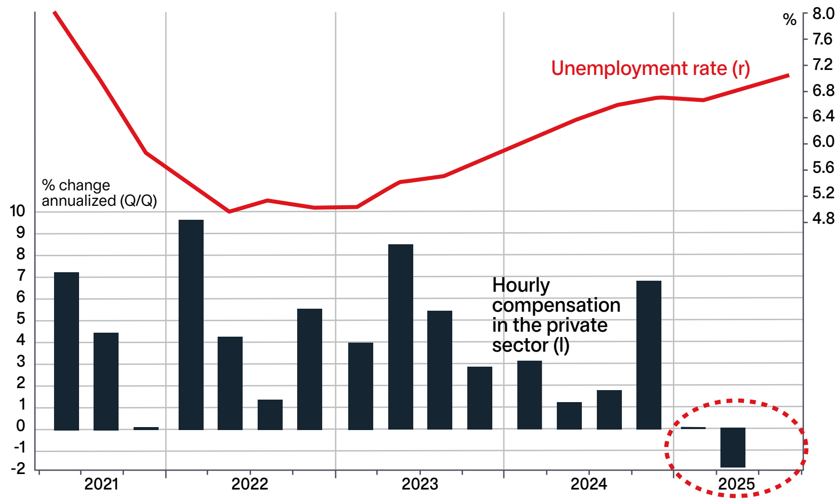
Canada

The trade dispute with the United States continues to dominate economic headlines. While the multiple tariffs officially imposed on Canada may seem significant, the reality is less worrying. It turns out that the free trade agreement (CUSMA) limits the scope of certain tariffs, particularly those related to security issues and the automotive industry. In July, nearly 85% of goods imported by the United States were now compliant with CUSMA, and we are comfortable with our estimate that, under current conditions, the effective tariff rate does not exceed 5%, which is well below the 19% average imposed by Washington on its trading partners. The fact remains that certain sectors are facing prohibitive tariffs, the direct impact of which is undeniable. In addition, the entire Canadian economy is weighed down by uncertainty, with business leaders fearing new measures from the U.S. administration, or even an undesirable outcome to the negotiations to revise the free trade agreement. GDP contracted in the second quarter, with exports and investment falling sharply. The paralysis of businesses is also reflected in the labour market, which continues to deteriorate, with the unemployment rate now exceeding 7%. Job losses are not limited to sectors sensitive to trade with the United States. Of the 250 industries of the private sector, only 36% recorded an increase in employment over the past 6 months, a proportion usually seen in times of recession.

The deterioration in the labour market is also reflected in wage pressures, which have been very weak since the beginning of the year. In this context, the Bank of Canada resumed cutting interest rates in September and may do so again in October to give some breathing room to a faltering economy. This should help ensure that the rebound in residential activity is sustainable and limit the interest payment shock that many mortgage holders are facing. Subsequently, the Bank of Canada will have to adapt its actions in line with developments in the trade situation, but also with the federal budget in November, which could also stimulate the Canadian economy. Against a backdrop of weak population growth, we forecast GDP growth of just 1.2% in 2025 and 2026. This incorporates economic weaknesses that are expected to persist until the end of the year and a potential upturn next year, assuming a de-escalation of trade tensions with the United States.

Canada: Wage pressures ease rapidly as the labour market deteriorates

Unemployment rate and hourly compensation in the business sector (productivity account)



NBC Economics and Strategy (data via Statistics Canada)

Investment Strategy

Markets maintained their momentum in the third quarter, led by Emerging Markets and Canadian equities. Canadian stocks benefited from strength in cyclical sectors, particularly Financials, Energy, and Materials. Moreover, U.S. equities also moved higher, though gains were more restrained due to already elevated valuations. In fixed income, Canadian bonds posted slightly positive returns, benefiting from a drop in yields late in the quarter.

Over the summer, macroeconomic conditions remained relatively stable, with inflation holding near 2% in Canada and a bit higher, around 3%, in the United States. However, the winds appear to be shifting in the labour market, where there are more serious signs of a slowdown, as the pace of job creation slowed and the unemployment rate ticked up to its highest level since 2021. This evolving environment has prompted central banks to recalibrate their policy stance, with both the Bank of Canada and the Federal Reserve cutting rates in September and suggesting that further easing is now on the table.

Against this backdrop, our base case scenario of moderate economic growth and above-target inflation in the U.S. remains largely unchanged. While challenges remain, global activity should be supported by improving financial conditions and a more favourable fiscal and monetary stance in the coming quarters. In terms of key risks, a further deterioration of the labour market cannot be ruled out, while an acceleration in inflation could quickly call into question market expectations of upcoming Fed rate cuts. Thus, after a remarkably calm summer, volatility could increase in the coming months as markets digest the constantly changing economic and geopolitical environment.

Under these conditions, we maintained our moderate risk-on stance through an overweight position in equities relative to fixed income. Within equities, we continue to favour Canada over the U.S., reflecting our view that Canadian markets offer a more interesting sector composition considering the current economic environment. Finally, despite the dovish bias toward interest rate cuts by central banks, bonds are likely to continue to trade without direction, given the lack of visibility on the longer-term trajectory of inflation and fiscal deficits.

Model portfolios	Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
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.	Cash equivalents	0% to 20%	5.0%	3.0%	0.0%
	Fixed income (duration: 6.5 years)[1]	60% to 100%	70.0%	70.5%	0.0%
	Canadian equities	0% to 30%	8.0%	9.0%	0.0%
	U.S. equities		8.0%	8.5%	0.0%
	Foreign equities		4.0%	4.0%	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.	Cash equivalents	0% to 20%	5.0%	3.0%	0.0%
	Fixed income (duration: 6.5 years)[1]	45% to 80%	55.0%	55.5%	0.0%
	Canadian equities	20% to 45%	14.0%	15.0%	0.0%
	U.S. equities		14.0%	14.5%	0.0%
	Foreign equities		7.0%	7.0%	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.	Cash equivalents	0% to 20%	5.0%	3.0%	0.0%
	Fixed income (duration: 6.5 years)[1]	30% to 65%	40.0%	40.5%	0.0%
	Canadian equities	30% to 65%	18.0%	19.0%	0.0%
	U.S. equities		18.0%	18.5%	0.0%
	Foreign equities		9.0%	9.0%	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.	Cash equivalents	0% to 25%	5.0%	3.0%	0.0%
	Fixed income (duration: 6.5 years)[1]	20% to 45%	30.0%	30.5%	0.0%
	Canadian equities	40% to 75%	22.0%	23.0%	0.0%
	U.S. equities		22.0%	22.5%	0.0%
	Foreign equities		11.0%	11.0%	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%	5.0%	3.0%	0.0%
	Fixed income (duration: 6.5 years)[1]	0% to 30%	15.0%	16.0%	0.0%
	Canadian equities	55% to 100%	26.0%	27.0%	0.0%
	U.S. equities		26.0%	26.0%	0.0%
	Foreign equities		13.0%	13.0%	0.0%
	Alternative investments[2]	0% to 30%	15.0%	15.0%	0.0%

1 FTSE TMX Canada Universe Index

2 Includes 3-month T-bills, global infrastructure and gold.

Forecast	2023	2024	2025 (Forecast)	2026 (Forecast)
Gross Domestic Product %				
Canada	1.5	1.6	1.2	1.2
U.S.	2.9	2.8	2.0	2.0
Inflation %				
Canada	3.9	2.4	2.0	2.1
U.S.	4.1	3.0	2.7	2.9

	September 2025		December 2025		December 2026	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rates %						
Short-term rates (T-bills, 91-day)	2.35	3.90	2.25	3.65	2.65	3.10
10-year bond yields	3.25	4.05	3.15	4.10	3.30	4.15
30-year bond yields	3.70	4.75	3.60	4.80	3.65	4.75
Canadian Dollar	US $0.72		US $0.72		US $0.77	