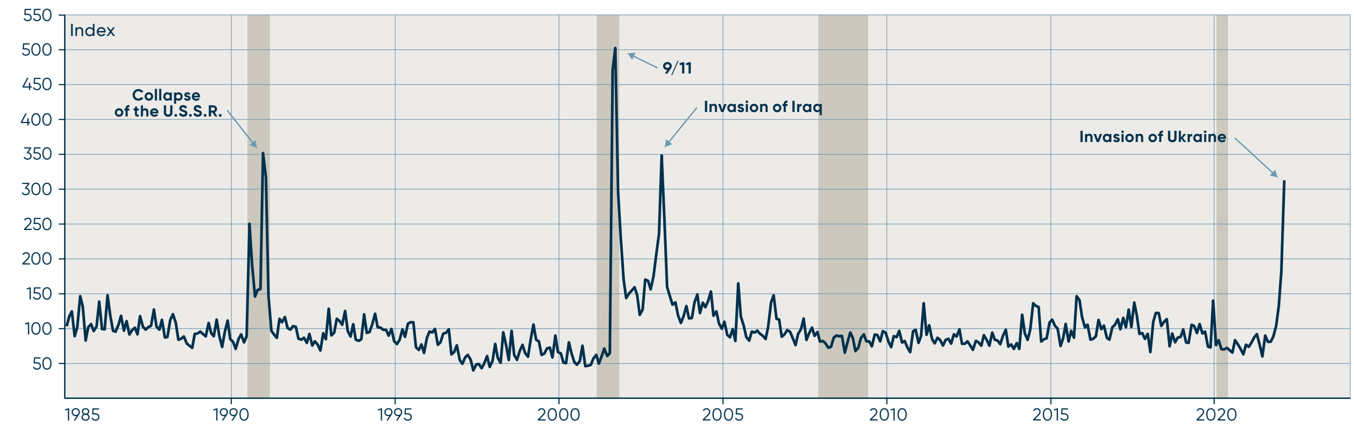
March 2022
Building your financial future

Investment Strategy

World

After several weeks of uncertainty, Vladimir Putin crossed the Rubicon. On February 24, the Russian president ordered his troops into Ukraine, plunging the world into one of its worst crises since the Second World War. Against an army vastly superior in technology and numbers, Ukrainian resistance was fiercer than expected, to the point that a rapid collapse of resistance now seems excluded. The conflict may instead bog down, threatening even worse human, diplomatic and economic consequences. The magnitude of the shock to global growth is hard to gauge at this writing. Suffice it to say that it could be substantial, especially in the increasingly likely event that hostilities will continue for weeks. Few countries will be spared and many will be shaken, beginning with a Russia labouring under a barrage of unprecedented economic sanctions. The rest of the globe will also take hits from the crisis, through various channels. On the financial side, the already marked retreat of equity markets could be exacerbated by forced write-off of some US$170 billion in Russian assets held by foreign investors. That's not counting the direct exposure of some multinationals—such as European banks—through subsidiaries operating in Russia. As for the real economy, many consumers and businesses around the world will be negatively impacted by the rise of commodity prices. Europe seems especially vulnerable because a good chunk of its electricity is generated from natural gas, whose prices have exploded. Global growth is also at risk of new disturbances in supply chains as China maintains a zero-COVID strategy. The marked increase in uncertainty prompts us to revise down our outlook for global growth from 4.0% to 3.8%. This relatively modest change takes into account the possibility of cessation of hostilities in Ukraine, which would of course reduce, without completely eliminating, some of the risk factors noted above. That said, the longer the conflict continues, the greater the likelihood that these risks will materialize, doing permanent damage to the global economy. If the belligerents do not find ground for agreement, further downward adjustments to our outlook will be in order.

World: Geopolitical uncertainty the highest since the invasion of Iraq
Geopolitical Risk Index (Dario Caldara and Matteo Iacoviello)



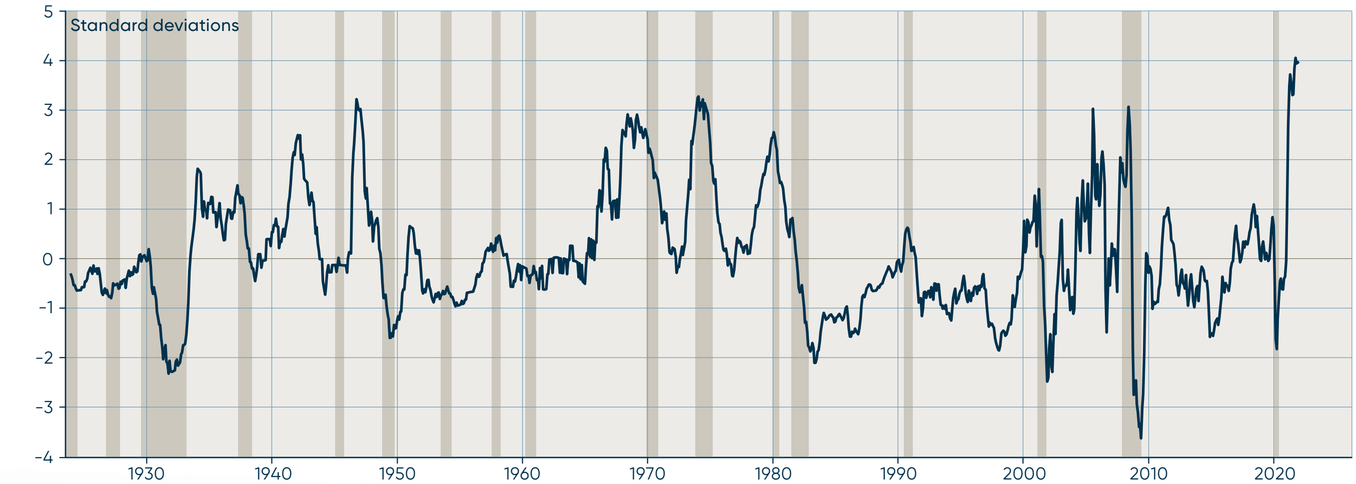
NBF Economics and Strategy (data via https://www.matteoiacoviello.com/gpr.htm)

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

In this issue

United States

Relative to other regions of the world, the U.S. seems fairly to deal with the by-blows of the conflict raging in eastern Europe. Over the last five years, a tiny 0.7% of its trade in goods has been with Russia, compared to 4.0% of the Eurozone's. That said, the slightness of Russia-U.S. trade will not isolate U.S. consumers from indirect effects of the crisis. Since energy products are traded on global markets, the world's largest economy will not be spared the rise of oil prices. But to what extent will household spending be affected? In other circumstances, the price rises tied specifically to the Ukraine conflict would likely have been insufficient to derail consumption. The problem is that these rises come at a time when inflation is already very high and consumer confidence is at a 10-year low. We also note that a growing share of respondents expected their incomes to rise more slowly than prices over the next 12 to 24 months. Judging by the most recent data released by the Atlanta Fed, this expectation could well prove accurate. Those data show that despite strong rises in nominal terms, real wages have been declining for 11 months now. This means than to maintain their spending, households must henceforth draw on their savings. Their rate of saving is now below its pre-pandemic level and likely to stay there for some time. This "undersaving" does not disturb us unduly given that their excess savings remain substantial (almost $2.4 trillion by our estimate). But even a substantial nest egg will not last forever if inflation does not return to more normal rates in the medium term. For this reason we think the Federal Reserve will raise its policy rate four times between now and the end of 2022 (including the quarter-point hike expected at the meeting of March 15–16). The growing number of challenges facing the U.S. economy prompts us to keep our outlook for its growth this year below the consensus expectation (+3.1%). For next year, we see growth close to potential (+2.1%).



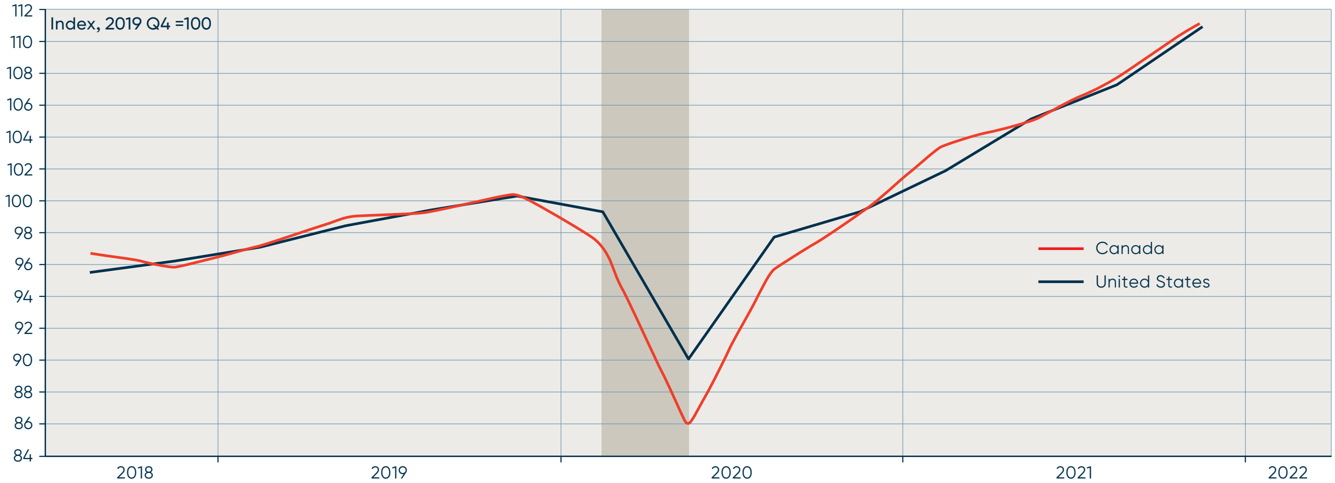
NBF Economics and Strategy (data from Bloomberg and St. Louis Fed FRED)

Canada

Canada is well positioned to deal with the impact of higher commodity prices. Despite tighter COVID restrictions than in the U.S., real GDP growth exceeded expectations with a gain of 6.7% in the last quarter of 2021. Nominal GDP, meanwhile, jumped 13.7% on an annualized basis. This is good news for the fiscal health of Canadian governments, corporate profits and job creation. In fact, employment registered a spectacular gain of 336,600 in February, the best the best performance in 17 months. This gain allowed the unemployment rate to fall from 6.5% to 5.5%, just one-tenth above the record low registered in May 2019. Against this backdrop, and after nearly two full years of an effective lower bound policy setting, the Bank of Canada opted to increase its overnight rate target by 25 basis points to 0.50% on March 2—a move in line with the consensus. With the Bank citing high-than-expected growth and upside risks to inflation, it appears that a steady dose of normalization continues to be in the cards.

Canada: Nominal GDP expansion matches that in the U.S.

Nominal GDP: Canada vs. the U.S.



NBF Economics and Strategy (data via Refinitiv)

Investment Strategy

It has been a volatile start to the year for markets, to say the least. While the economy proved surprisingly resilient in the face of the Omicron wave, the pivot of major central banks toward faster monetary tightening led to some serious market jitters in January. The subsequent geopolitical crisis in Ukraine, and the severe sanctions against Russia that accompanied it, gave rise to even more uncertainty. Oil prices rose significantly, as did the price of a wide array of commodities such as wheat, gold, nickel, and many more. Global equities declined; European stocks bore the brunt of the losses, but major U.S. indices also went into correction territory. On the other hand, Canada's status as a major commodity exporter means that the country's economy actually benefits from rising prices, leading Canadian stocks to widely outperform their global peers.

Europe's heavy reliance on Russian energy and the inflationary nature of the conflict are core areas of concern for markets. Indeed, the European Union imports 41% of its natural gas and 27% of its crude oil from Russia; uncertainty surrounding these energy flows has contributed to the recent growth in prices. But, because commodity markets are global, the resulting inflationary pressures aren't confined to Europe, as evidenced by the worldwide increase of gasoline prices over the last few weeks. This, in turn, has fuelled market anxiety because rapidly rising energy costs can have a negative impact on economic growth, as households adjust their budgets and cut back on discretionary spending in response.

Adding to the complexity of the situation is the fact that inflation was sitting at an uncomfortably high level even before Russia's moves against Ukraine. Much to the dismay of central banks, this conflict will add to existing price pressures and delay the normalization process of inflation. But, while risks surrounding the current geopolitical environment certainly warrant caution, there are also encouraging signs that the economy is still doing very well. In addition to real GDP growth remaining elevated by historical standards, the Canadian and U.S. labour markets are undeniably strong; employment continues to recover from COVID-related disruptions and wages are growing at a brisk pace. Moreover, consumer spending is high and should be further supported by fading public health restrictions and ample reserves of excess savings accumulated during the pandemic.

However, the advent of the most serious European military conflict since the end of World War II suggests greater downside risks and more volatility surrounding our base-case outlook. A wide range of scenarios is possible but, for now, the main tangible risk appears to come from Russia completely cutting off European natural gas. Such a move could very well send Europe into recession and significantly slow down global economic growth. Beyond this particular development, persistent price pressures forcing central banks to raise interest rates more rapidly remain a key risk factor for the upcoming quarters.

Against this backdrop, we continue to heavily favour North American stocks (which have low exposure to the Russian economy) over their European and emerging market counterparts. Canada's flagship index (S&P/TSX) has thrived so far this year, with the high sector weighting of energy and materials proving to be a serious advantage in an environment of rising commodity prices. On the other hand, the defensive properties of U.S. equities could prove beneficial in the event of a global slowdown. As for bonds, we believe the outlook remains poor, although the worst could be behind us. In the end, the fog of war is still thick, and much is uncertain. Geopolitical developments in Ukraine will be determining factors behind market performance over the next quarter and, accordingly, geographic positioning will be of utmost importance for investors.

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%	6.5%	0.0%
Fixed income (duration: 5.50 years)[1]	60% to 100%	70.0%	63.5%	0.0%
Canadian equities	0% to 30%	8.0%	11.25%	0.50%
U.S. equities		8.0%	10.75%	0.00%
Foreign equities		4.0%	3.0%	-0.5%
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%	6.5%	0.0%
Fixed income (duration: 5.50 years)[1]	45% to 80%	55.0%	48.5%	0.0%
Canadian equities	20% to 45%	14.0%	17.5%	0.5%
U.S. equities		14.0%	17.0%	0.0%
Foreign equities		7.0%	5.5%	-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.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	5.0%	6.0%	0.0%
Fixed income (duration: 5.50 years)[1]	30% to 65%	40.0%	34.0%	0.0%
Canadian equities	30% to 65%	18.0%	22.0%	1.0%
U.S. equities		18.0%	21.0%	0.0%
Foreign equities		9.0%	7.0%	-1.0%
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%	6.0%	0.0%
Fixed income (duration: 5.50 years)[1]	20% to 45%	30.0%	24.0%	0.0%
Canadian equities	40% to 75%	22.0%	26.0%	1.0%
U.S. equities		22.0%	25.0%	0.0%
Foreign equities		11.0%	9.0%	-1.0%
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%	6.0%	0.0%
Fixed income (duration: 5.50 years)[1]	0% to 30%	15.0%	9.0%	0.0%
Canadian equities	55% to 100%	26.0%	30.0%	1.0%
U.S. equities		26.0%	29.0%	0.0%
Foreign equities		13.0%	11.0%	-1.0%
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

	2020	2021	2022 (Forecast)	2023 (Forecast)
Gross Domestic Product %				
Canada	(5,2)	4,6	3,6	2,4
U.S.	(3,4)	5,7	3,1	2,1
Inflation %				
Canada	0,7	3,4	4,8	2,3
U.S.	1,3	4,7	6,5	2,9

	June 2022		December 2022		December 2023	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-bills, 91-day)	1,05	0,70	1,45	1,20	1,60	2,10
10-year bond yields	2,10	2,15	2,20	2,25	2,05	2,25
30-year bond yields	2,35	2,45	2,35	2,50	2,20	2,45
Canadian Dollar	US $0.80		US $0.81		US $0.79	