ETF STRATEGY
Tactical Asset Allocation: June 2014

ETF RESEARCH & STRATEGY

June 9, 2014

- ***We continue to favor stocks expecting further upside in the near and long term***
- ***We still prefer developed over emerging market equities with small caps offering greater upside***
- ***Despite the recent rebound we believe the trend for the Canadian dollar remains downward***
- ***Fixed Income durations should be kept short with overweight positions in lower credit issuers***

Our recommended ETFs to express National Bank's Asset Allocation Strategy:

Table 1 - Recommended ETFs

Asset Class		Ticker	Fund Name	Price ($)	Type*	QMV ($M)	20D ADV (000)	MER (%)
Equity	U.S. Broad	VTI US	Vanguard Total Stock Market ETF	101.47	USL	44,201	1,549	0.05
		VUN CN	Vanguard US Total Market Index ETF	30.13	UnH	166	45	0.17
	U.S. Small Cap	IJR US	iShares Core S&P Small-Cap ETF	111.10	USL	13,899	732	0.17
		VB US	Vanguard Small-Cap ETF	115.07	USL	9,002	337	0.09
	EAFE	XEF CN	iShares MSCI EAFE IMI Index ETF	25.33	UnH	177	43	0.20**
		VDU CN	Vanguard FTSE Developed ex North America	29.58	UnH	138	22	0.31
	U.S. Technology	XLK US	Technology Select Sector SPDR Fund	38.36	USL	12,968	5,180	0.17
		VGT US	Vanguard Information Technology ETF	95.71	USL	5,440	277	0.14
		IYW US	iShares US Technology ETF	96.14	USL	4,153	241	0.46
Fixed Income	Short Term High Yield	HYS US	PIMCO 0-5 Year High Yield Corporate Bond	106.89	USL	5,061	361	0.55
		SJNK US	SPDR Barclays Short Term High Yield Bond	30.87	USL	4,262	860	0.40
		CSD CN	iShares Adv Short Duration High Income	20.46	C$H	360	77	0.61

**Type: US-Listed (USL); US dollar (USD); With currency hedge (C$H), and Non-hedged (UnH); **Stated Mgt Fee; Source: NBF, Bloomberg as of 9-June-14*

Asset Allocation Strategy Report: *Bonds away!* – *June 4, 2014*

Reference: Martin Lefebvre, Asset Allocation and Investment Strategist

- **Fixed income:** The more bond yields fall, the less you want to own them. Yields on U.S. 10-year notes bounced off their technical support level of 2.40% on the prospect that economic growth would accelerate after contracting by 1% in Q1 2014.
- **Equities:** Stocks continue to offer the best expected returns over both the short and longer-term horizons. We still favour developed markets over emerging markets. IT stocks still have potential, but late cyclical sectors such as energy and materials could be limited by the appreciation of the USD. Therefore, now is not a good time to increase the weighting of the TSX in portfolios.
- **Currencies:** The Canadian dollar got a break from weaker growth in the United States, but the path of least resistance for the loonie remains downward, particularly now that the European Central Bank looks set to announce further easing of its monetary policy at its June meeting.

Table 2 - Global Asset Allocation 3-Month Horizon

Asset Classes	Weight: Min	Under	Equal	Over	Max
Cash			■		
Bonds		■			
(Duration)		■			
Federal		■			
Investment Grade			■		
High Yield (USD)				■	
Non-traditional Income				■	
World Equities				■	
S&P/TSX			■		
S&P 500 (USD)				■	
Growth vs. Value			■		
Large Cap vs. Small Cap			■		
Defensives vs. Cyclicals		■			
MSCI EAFE (USD)				■	
MSCI EM (USD)			■		
Alternative Investments			■		
Commodities			■		
Energy				■	
Base Metals				■	
Gold		■			
Hedge Funds (USD)			■		
REITs		■			

Source: Consulting Investment Committee, NBF

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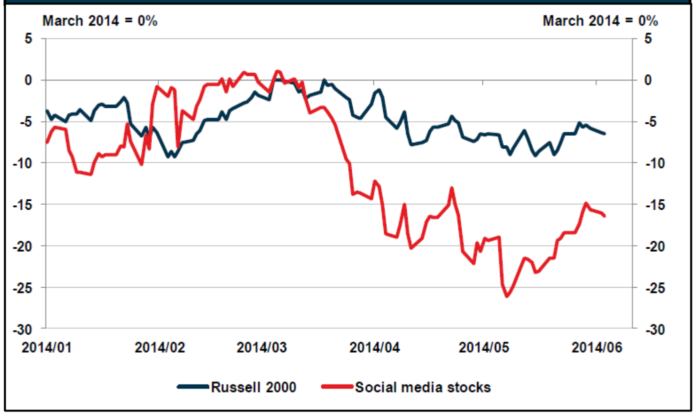
- **Commodities:** Raw materials continue to suffer as a result of slower demand from emerging markets. Technically, the price of gold bullion is due for a rebound, but it will most likely continue on its downward path towards US$1,200 on the prospect of rising interest rates and strengthening USD.

Small caps and momentum stocks still lagging
Source: NBF. Datastream

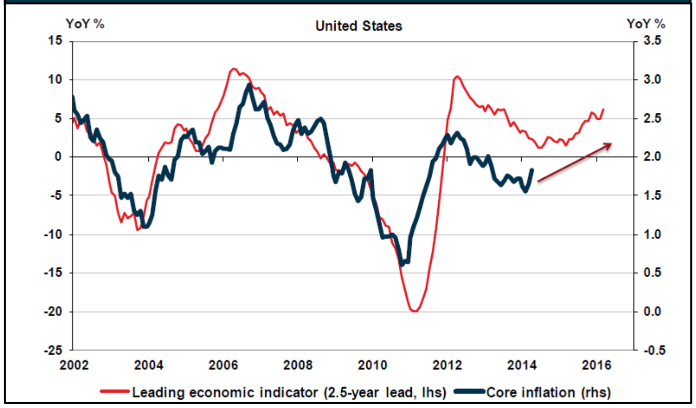


- With the month of May now behind us and June and July historically having offered decent returns on average, we believe that there is still room for the market to climb higher.
- This being said, as overbought conditions have been worked down, small caps and momentum stocks (such as social media) appear to offer more upside in the near term since they remain well below their March peak, and should benefit most from the marked improvement in the U.S. surprise index.

Good progress, but the best is likely yet to come
Source: NBF. Datastream

- While the bubble was most obvious towards the end of the dotcom era, it turns out that the cycle lasted a lot longer, nearly two decades in fact.
- Using the end of the early 90s' recession as a starting point for the Nasdaq index and matching it with the progress made since the end of the great recession of 2008, it seems we are still in the early innings

Inflation is a lagging indicator
Source: NBF. Datastream



- With regard to inflation, there is no doubt that excess capacity in the U.S. economy (negative output gap) will continue to limit upward pressure. However, inflation is a lagging indicator for the economic cycle and a strong pick-up in U.S. leading indicators suggest that inflation will soon reverse its recent downward trend
- While wage growth remains subdued, house prices are rising fast and should continue pushing up shelter costs, the most important component of the consumer price basket

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