

Highlights

- The first half of 2017 has been good for global equity markets. Encouragingly, markets are being lifted by earnings growth rather than P/E expansion. At this writing, the consensus expects MSCI AC index earnings to grow 12.4% over the next 12 months.
- The S&P 500 rose to a new all-time high in June, with eight of the 11 major sectors setting new records. With a forward P/E of about 18, the S&P 500 has become expensive compared to its global peers. While we are comforted to see that upward earnings revisions for the S&P 500 companies are the most widespread in three years, we see this development more as a guard against downside than as a harbinger of significant upside.
- At mid-year the S&P/TSX remains one of the worst-performing country benchmarks. Energy, Banks and Materials have all struggled in Q2. We expect these sectors to do better in the second half of the year. The domestic economy remains sound and corporate profits have rebounded.
- We are changing our asset allocation this month by reducing our cash position in favour of Canadian equities. Our decision is based on our view that global economic momentum will improve in the second half of the year. This development argues for a reflation trade scenario, implying a somewhat weaker U.S. dollar and stronger commodity prices.
- In sector rotation, we are increasing our recommendation for Energy stocks from underweight to market weight. Telecoms, real estate and utilities are downgraded to an underweight recommendation.

Stéfane Marion

stefane.marion@nbc.ca

Matthieu Arseneau

matthieu.arseneau@nbc.ca

Monthly Equity Monitor

Outlook still constructive

The first half of 2017 has been good for global equity markets – a total return of 10.1%. So far this year the heavy lifting has been done by Emerging Asia, Europe and the U.S. (table).

MSCI composite index: Price Performance (Total return)

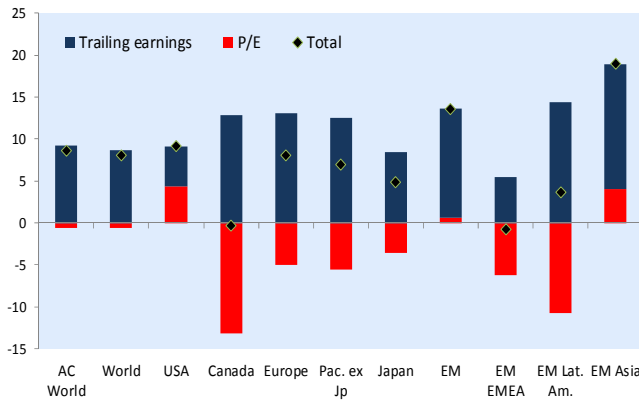
| | Month to date | Quarter to date | Year to date |
|-----------------------|---------------|-----------------|--------------|
| MSCI AC World | 1.0 | 4.0 | 10.1 |
| MSCI World | 0.9 | 3.7 | 9.5 |
| MSCI USA | 1.2 | 3.7 | 10.2 |
| MSCI Canada | -0.2 | -1.2 | 0.9 |
| MSCI Europe | -0.2 | 4.3 | 10.8 |
| MSCI Pacific ex Jp | 0.0 | 0.9 | 9.0 |
| MSCI Japan | 2.6 | 6.0 | 5.9 |
| MSCI EM | 1.4 | 6.4 | 14.7 |
| MSCI EM EMEA | -1.7 | 1.0 | 1.0 |
| MSCI EM Latin America | -1.3 | -2.4 | 5.1 |
| MSCI EM Asia | 2.5 | 9.2 | 19.8 |

6/23/2017

NBF Economics and Strategy (data via Datastream)

Encouragingly, markets are being lifted by earnings growth rather than P/E expansion. In fact trailing P/Es have declined in most regions since the beginning of the year (chart).

World: Breakdown of equity-market return (year-to-date)

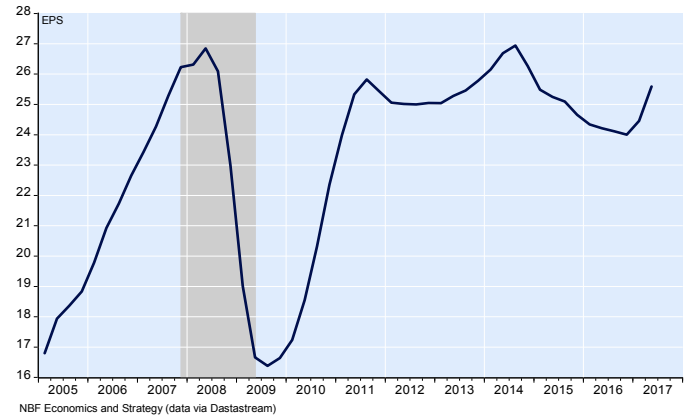


NBF Economics and Strategy (data via Datastream)

As the next chart illustrates, profits continue to recover from their debacle of 2014-16. In our opinion, earnings could still surprise on the upside in the coming months.

World: Profits are still recovering

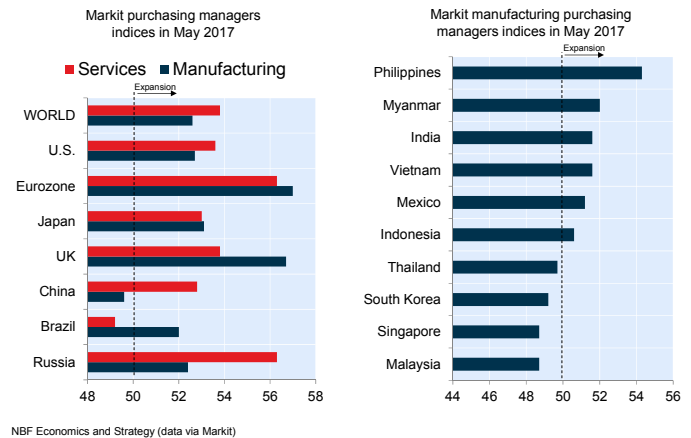
Trailing earnings for the MSCI AC



NBF Economics and Strategy (data via Datastream)

World trade volume continues to grow faster than industrial production, pushing the ratio of industrial production to trade volume (a proxy for inventories) to the lowest in years. That's good news for production going forward. And to judge by Markit purchasing manager indexes, the global economy continued to expand in the second quarter. Most of the advanced and emerging economies are showing increases in both manufacturing and services output (chart).

World: Continued expansion in the second quarter



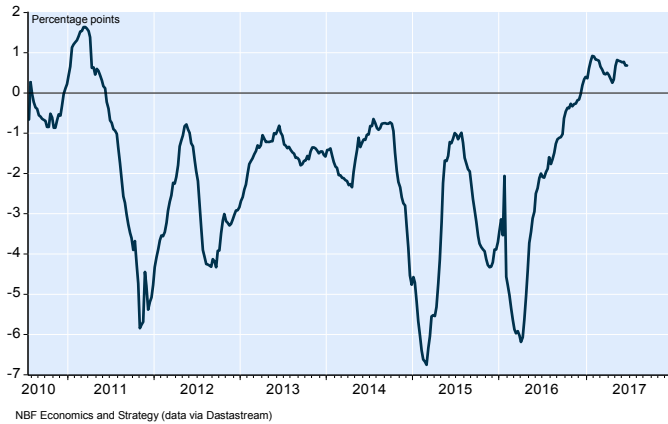
NBF Economics and Strategy (data via Markit)

The improving economic backdrop is conducive to upward earnings revisions. The bottom-up consensus of equity analysts for 12-month-forward earnings of the MSCI AC has been revised up every week since the beginning of the year (chart). As long as this continues, equity markets have limited downside. At this writing, the consensus expects MSCI AC index earnings to grow 12.4% over the next 12 months (table).

Monthly Equity Monitor

World: Earnings still being revised up

3-month change in 12-month-forward MSCI AC earnings growth



MSCI composite index: EPS Performance

| | 2016 | 2017 | 2018 | 2019 | 12 months forward |
|-----------------------|------|------|------|------|-------------------|
| MSCI AC World | 2.0 | 14.5 | 10.7 | 9.9 | 12.4 |
| MSCI World | 1.1 | 13.6 | 10.6 | 9.7 | 11.8 |
| MSCI USA | 2.3 | 10.6 | 12.3 | 10.7 | 11.5 |
| MSCI Canada | -4.5 | 23.2 | 11.5 | 12.3 | 16.4 |
| MSCI Europe | -3.9 | 18.9 | 9.2 | 9.0 | 13.1 |
| MSCI Pacific ex Jp | -7.8 | 16.3 | 4.8 | 5.6 | 6.4 |
| MSCI Japan | NA | 16.1 | 12.1 | 7.5 | 10.8 |
| MSCI EM | 7.8 | 20.4 | 11.4 | 10.8 | 16.0 |
| MSCI EM EMEA | 6.2 | 13.9 | 14.8 | 7.5 | 16.2 |
| MSCI EM Latin America | 59.4 | 24.8 | 8.8 | 17.9 | 16.3 |
| MSCI EM Asia | 2.8 | 21.4 | 11.0 | 10.4 | 15.9 |

6/23/2017

NBF Economics and Strategy (data via Dastream)

U.S.: The economy must deliver

The S&P 500 rose to a new all-time high in June, with eight of the 11 major sectors setting new records. At this juncture, the outlooks for both economic growth and profits remain encouraging.

U.S.: A new record in June

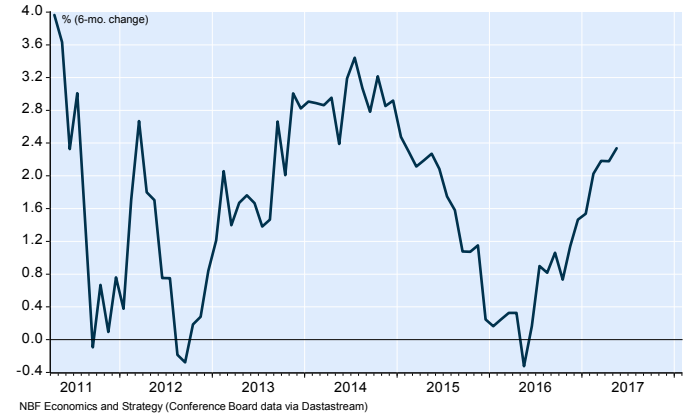
S&P 500



First, the uptrend of the U.S. leading economic indicator is the most pronounced in three years (chart). Second, more than 1.3 million full-time jobs were added in the first five months of 2017. As the labour market continues to tighten, full-time workers are enjoying higher wage growth (chart). We remain confident that this will translate into faster growth of consumer spending in the second half of the year.

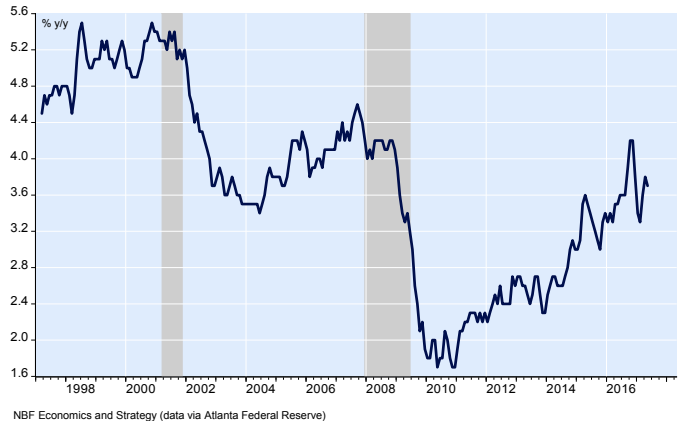
U.S.: Economic outlook still constructive

Growth in the leading economic indicator



U.S.: Improved consumer purchasing power

Growth of median wage of people who usually work full-time



Much of this good news, however, is already embedded in U.S. equity prices. With a forward P/E of about 18, the S&P 500 have become expensive compared to its global peers (table). While we are comforted to see that upward earnings revisions for the S&P 500 companies are the most widespread in three years (chart, next page), we see this development more as a guard against downside than as a harbinger of significant upside.

Monthly Equity Monitor

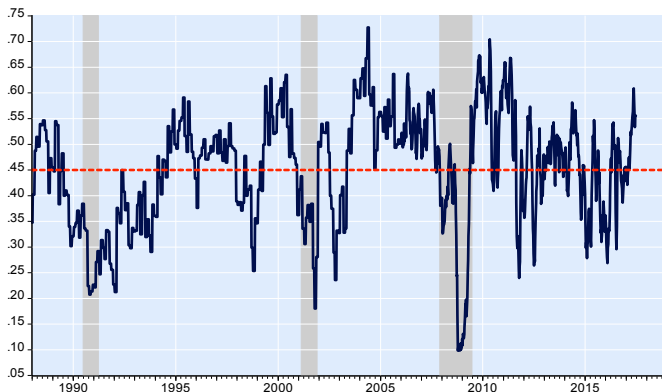
MSCI Composite Index: Valuations (forward P/Es)

| | 6/23/2017 | A year ago | 10 year ave. | 5 year average |
|-----------------------|-----------|------------|--------------|----------------|
| MSCI AC World | 16.0 | 15.3 | 13.3 | 14.4 |
| MSCI World | 16.6 | 15.8 | 13.6 | 14.9 |
| MSCI USA | 18.0 | 16.9 | 14.4 | 15.8 |
| MSCI Canada | 15.0 | 16.5 | 14.0 | 14.8 |
| MSCI Europe | 15.1 | 14.7 | 12.2 | 13.8 |
| MSCI Pacific ex Jp | 15.4 | 15.0 | 13.8 | 14.5 |
| MSCI Japan | 14.3 | 13.0 | 14.8 | 13.7 |
| MSCI EM | 12.1 | 11.8 | 11.0 | 11.0 |
| MSCI EM EMEA | 9.8 | 10.2 | 9.0 | 9.2 |
| MSCI EM Latin America | 12.1 | 13.1 | 11.9 | 12.7 |
| MSCI EM Asia | 12.7 | 12.0 | 11.7 | 11.2 |

NBF Economics and Strategy (data via Datastream)

U.S.: Diffusion of upward earnings revisions

Fraction of S&P 500 companies whose 12-month-forward earnings has been revised up over the past 3 months

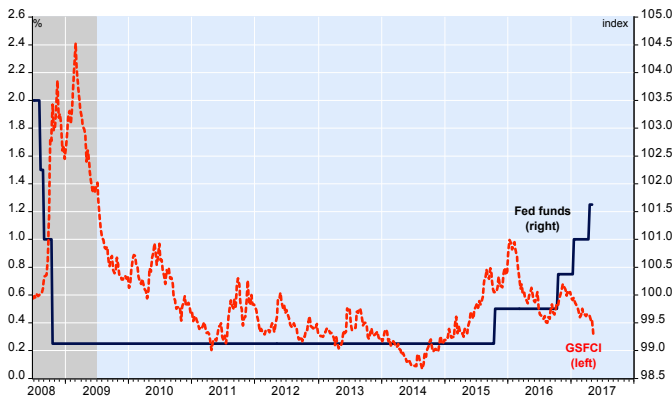


NBF Economics and Strategy (data via Datastream)

Given the current economic backdrop, we expect Treasury yields to head higher before the year end. Our target for the 10-year note is 2.7%. Rising yields notwithstanding, we expect financial conditions in the U.S. to remain pro-growth. Even after four Federal Reserve rate hikes, the financial conditions index (an aggregate of interest rates, the stock market, corporate spreads and the USD) is the most accommodative in three years (chart).

U.S.: Financial conditions still easing

GS financial conditions index and federal funds rate



NBF Economics and Strategy (data via Bloomberg)

Canada: Rebound in the offing

At mid-year the S&P/TSX remains one of the worst-performing country benchmarks. Energy, Banks and Materials have all struggled in Q2 (table).

S&P/TSX composite index: Price Performance

| | Month to date | Quarter to date | Year to date |
|-------------|---------------|-----------------|--------------|
| S&P TSX | -0.2 | -1.5 | 0.2 |
| HEALTH CARE | 11.2 | 10.8 | -0.7 |
| BANKS | 2.2 | -2.5 | 1.0 |
| FINANCIALS | 2.0 | -2.0 | 0.5 |
| UTILITIES | 1.8 | 3.3 | 9.6 |
| INDUSTRIALS | 1.0 | 6.7 | 12.0 |
| CONS. DISC. | 0.8 | 5.6 | 12.4 |
| REAL ESTATE | 0.4 | 1.6 | 5.0 |
| IT | -0.1 | 6.7 | 14.0 |
| MATERIALS | -0.8 | -3.4 | 2.2 |
| TELECOM | -2.3 | 2.8 | 6.8 |
| CONS. STAP. | -3.3 | 1.2 | 3.5 |
| ENERGY | -3.9 | -8.6 | -14.3 |

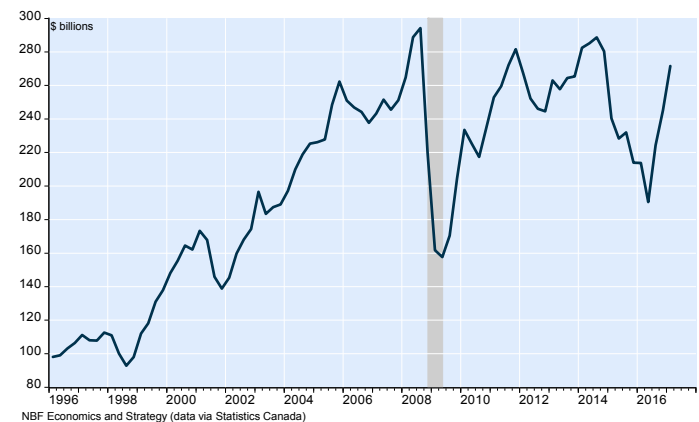
6/23/2017

NBF Economics and Strategy (data via Datastream)

We expect these sectors to do better in the second half of the year. The domestic economy remains sound. Nominal GDP has expanded at more than 7% annualized for three consecutive quarters, the best run since 2004. Corporate profits have rebounded accordingly and are back almost to the level of 2014 (chart).

Canada: Profits have rebounded

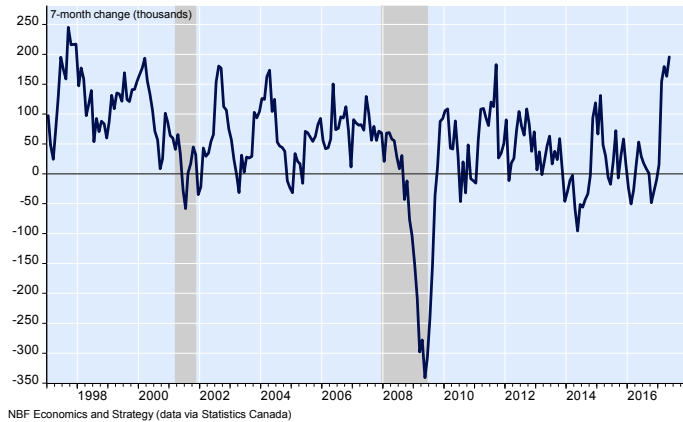
Corporate profits



Better profits have also meant a sizeable increase in full-time employment for prime-aged workers (25 to 54 years old). Their ranks have swelled by almost 200,000 since the end of last year, the best run in two decades (chart). This hiring supports credit growth, consumer spending and the housing market. It also means that the Bank of Canada is likely to raise interest rates before year end. We expect that these developments will reassure investors about the prospects for Canadian banks and improve sentiment toward the S&P/TSX.

Canada: Full-time employment is surging

Full-time employment for 25-54 population

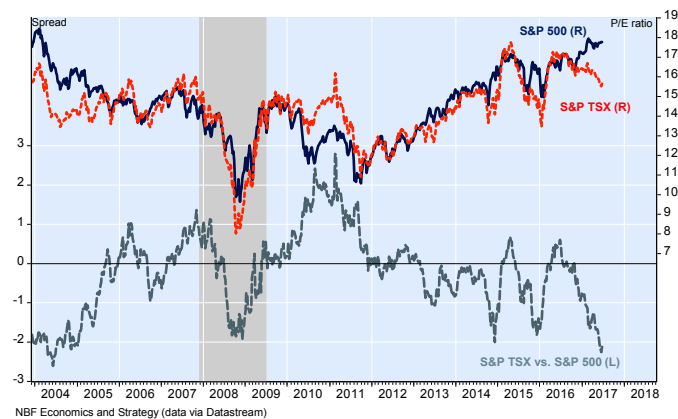


Asset allocation

We are changing our asset allocation this month by reducing our cash position in favour of Canadian equities. Our decision is based on our view that global economic momentum will improve in the second half of the year. This development argues for a reflation trade scenario, implying a somewhat weaker U.S. dollar and stronger commodity prices. That should buoy the S&P/TSX, which is currently trading at a significant discount to the S&P 500. At this writing, the spread between the 12-month-forward P/E's of the S&P 500 and the S&P/TSX is the widest since 2004 (chart).

S&P TSX: Perspective on relative equity valuation

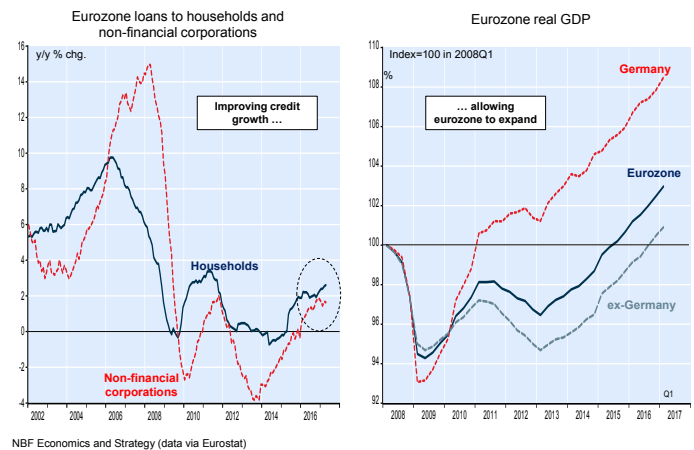
Price to 12 month forward earnings (weekly data)



Given our more constructive view on Europe, we are also increasing our allocation to EAFE stocks to the detriment of the U.S. The Eurozone's outlook has improved markedly since the start of the year. The composite PMIs in both Germany and France jumped to six-year highs in May.

Consumption spending is holding up well in both of those Eurozone powerhouses, with France's retail PMI even surging in May to the highest in 67 months. According to Markit, the overall data paints a positive picture of the retail sector in the Eurozone. The uptick in credit growth for households is no doubt helping (chart). But so is rising employment. Latest Eurostat data shows employment rising to an all-time high in Q1, surpassing the 2008 peak for the first time.

Eurozone: Credit growth fueling expansion



Sector rotation

In sector rotation, we are increasing our recommendation for Energy stocks from underweight to market weight. This move is consistent with our current year end target of US\$50 for WTI. To accommodate this change, we are reducing telecoms, utilities and real estate to underweight as those sectors are vulnerable to a rise in interest rates.

| NBF Asset Allocation | | | |
|-------------------------|---------------|------------------------|-------------|
| | Benchmark (%) | NBF Recommendation (%) | Change (pp) |
| Equities | | | |
| Canadian Equities | 20 | 24 | +3 |
| U.S. Equities | 20 | 17 | -3 |
| Foreign Equities (EAFE) | 5 | 8 | +3 |
| Emerging markets | 5 | 5 | |
| Fixed Income | 45 | 39 | |
| Cash | 5 | 7 | -3 |
| Total | 100 | 100 | |

NBF Economics and Strategy

Monthly Equity Monitor

| NBF Market Forecast | | | |
|----------------------------|------------------|----------------------|----------------------|
| Canada | | | |
| | <i>Actual</i> | <i>Q42017 (Est.)</i> | |
| <i>Index Level</i> | <i>Jun-27-17</i> | <i>Target</i> | |
| S&P/TSX | 15,281 | 16,100 | |
| Assumptions | | | <i>Q42017 (Est.)</i> |
| Level: | Earnings * | 820 | 875 |
| | Dividend | 432 | 462 |
| PE Trailing (implied) | 18.6 | 18.4 | |
| | | | <i>Q42017 (Est.)</i> |
| Treasury Bills (91 days) | 0.57 | 1.13 | |
| 10-year Bond Yield | 1.57 | 2.26 | |

* Before extraordinary items, source Thomson

NBF Economics and Strategy

| NBF Market Forecast | | | |
|----------------------------|------------------|----------------------|----------------------|
| United States | | | |
| | <i>Actual</i> | <i>Q42017 (Est.)</i> | |
| <i>Index Level</i> | <i>Jun-27-17</i> | <i>Target</i> | |
| S&P 500 | 2,419 | 2,500 | |
| Assumptions | | | <i>Q42017 (Est.)</i> |
| Level: | Earnings * | 123 | 130 |
| | Dividend | 49 | 51 |
| PE Trailing (implied) | 19.6 | 19.2 | |
| | | | <i>Q42017 (Est.)</i> |
| Treasury Bills (91 days) | 0.99 | 1.36 | |
| 10-year Bond Yield | 2.20 | 2.71 | |

* S&P operating earnings, bottom up.

NBF Fundamental Sector Rotation - July/August 2017

| Name (Sector/Industry) | Recommendation | S&P/TSX weight |
|--|----------------------|----------------|
| Energy | Market Weight | 20.0% |
| Energy Equipment & Services | Market Weight | 0.5% |
| Oil, Gas & Consumable Fuels | Market Weight | 19.4% |
| Materials | Market Weight | 11.6% |
| Chemicals | Underweight | 2.0% |
| Containers & Packaging | Market Weight | 0.6% |
| Metals & Mining * | Market Weight | 8.4% |
| Gold | Market Weight | 5.9% |
| Paper & Forest Products | Overweight | 0.5% |
| Industrials | Market Weight | 9.6% |
| Capital Goods | Overweight | 2.0% |
| Commercial & Professional Services | Underweight | 1.7% |
| Transportation | Market Weight | 6.0% |
| Consumer Discretionary | Underweight | 5.4% |
| Automobiles & Components | Underweight | 1.2% |
| Consumer Durables & Apparel | Overweight | 0.6% |
| Consumer Services | Underweight | 1.2% |
| Media | Market Weight | 1.1% |
| Retailing | Underweight | 1.3% |
| Consumer Staples | Underweight | 3.9% |
| Food & Staples Retailing | Underweight | 3.1% |
| Food, Beverage & Tobacco | Underweight | 0.8% |
| Health Care | Market Weight | 0.7% |
| Health Care Equipment & Services | Market Weight | 0.2% |
| Pharmaceuticals, Biotechnology & Life Sciences | Market Weight | 0.5% |
| Financials | Overweight | 34.2% |
| Banks | Overweight | 23.4% |
| Diversified Financials | Market Weight | 4.3% |
| Insurance | Overweight | 6.5% |
| Information Technology | Overweight | 3.3% |
| Software & Services | Overweight | 2.8% |
| Technology Hardware & Equipment | Market Weight | 0.5% |
| Telecommunication Services | Underweight | 4.9% |
| Utilities | Underweight | 3.3% |
| Real Estate | Underweight | 3.0% |

Monthly Equity Monitor

Economics and Strategy

Montreal Office

514-879-2529

Stéfane Marion

Chief Economist and Strategist

stefane.marion@nbc.ca

Paul-André Pinsonnault

Senior Fixed Income Economist

paulandre.pinsonnault@nbc.ca

Krishen Rangasamy

Senior Economist

krishen.rangasamy@nbc.ca

Marc Pinsonneault

Senior Economist

marc.pinsonneault@nbc.ca

Matthieu Arseneau

Senior Economist

matthieu.arseneau@nbc.ca

Angelo Katsoras

Geopolitical Analyst

angelo.katsoras@nbc.ca

Kyle Dahms

Economist

kyle.dahms@nbc.ca

Toronto Office

416-869-8598

Warren Lovely

MD, Public Sector Research and Strategy

warren.lovely@nbc.ca

General – National Bank Financial (NBF) is an indirect wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on Canadian stock exchanges.

The particulars contained herein were obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete. The opinions expressed are based upon our analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein.

Research Analysts – The Research Analyst(s) who prepare these reports certify that their respective report accurately reflects his or her personal opinion and that no part of his/her compensation was, is, or will be directly or indirectly related to the specific recommendations or views as to the securities or companies.

NBF compensates its Research Analysts from a variety of sources. The Research Department is a cost centre and is funded by the business activities of NBF including, Institutional Equity Sales and Trading, Retail Sales, the correspondent clearing business, and Corporate and Investment Banking. Since the revenues from these businesses vary, the funds for research compensation vary. No one business line has a greater influence than any other for Research Analyst compensation.

Canadian Residents – In respect of the distribution of this report in Canada, NBF accepts responsibility for its contents. To make further inquiry related to this report, Canadian residents should contact their NBF professional representative. To effect any transaction, Canadian residents should contact their NBF Investment advisor.

U.S. Residents – With respect to the distribution of this report in the United States, National Bank of Canada Financial Inc. (NBCFI) is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC). This report has been prepared in whole or in part by, research analysts employed by non-US affiliates of NBCFI that are not registered as broker/dealers in the US. These non-US research analysts are not registered as associated persons of NBCFI and are not licensed or qualified as research analysts with FINRA or any other US regulatory authority and, accordingly, may not be subject (among other things) to FINRA restrictions regarding communications by a research analyst with the subject company, public appearances by research analysts and trading securities held a research analyst account.

All of the views expressed in this research report accurately reflect the research analysts' personal views regarding any and all of the subject securities or issuers. No part of the analysts' compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report. The analyst responsible for the production of this report certifies that the views expressed herein reflect his or her accurate personal and technical judgment at the moment of publication. Because the views of analysts may differ, members of the National Bank Financial Group may have or may in the future issue reports that are inconsistent with this report, or that reach conclusions different from those in this report. To make further inquiry related to this report, United States residents should contact their NBCFI registered representative.

UK Residents – In respect of the distribution of this report to UK residents, National Bank Financial Inc. has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). National Bank Financial Inc. and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this report, or may act or have acted as investment and/or commercial banker with respect thereto. The value of investments can go down as well as up. Past performance will not necessarily be repeated in the future. The investments contained in this report are not available to retail customers. This report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. National Bank Financial Inc. is authorised and regulated by the Financial Conduct Authority and has its registered office at 71 Fenchurch Street, London, EC3M 4HD.

National Bank Financial Inc. is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

HK Residents – With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited ("NBCFMA") which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 (dealing in securities) regulated activity, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong ("SFO")). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates' businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including NBF, is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.

Copyright – This report may not be reproduced in whole or in part, or further distributed or published or referred to in any manner whatsoever, nor may the information, opinions or conclusions contained in it be referred to without in each case the prior express written consent of National Bank Financial.