

Asset Allocation Strategy

CIO Office | September 2025

Back to school

Highlights

- › With Summer drawing to a close, there's no denying that the hot season has been rather clement for equity markets, with equities posting gains for the fourth consecutive month in August.
- › However, we should not be under any illusions. Periods of low volatility can never last forever, and September is historically the month with the lowest average returns.
- › While inflation remains something to watch, it must be acknowledged that, for now, it is not as dramatic as some feared six months ago when the new tariffs were first introduced. In fact, for the first time since May 2021, small businesses in the U.S. are no longer more concerned about inflation than they are about weak sales.
- › In these changing circumstances, keeping interest rates at restrictive levels was becoming increasingly difficult to justify for the Fed, which should effectively begin a gradual transition to a neutral monetary policy shortly.
- › Unfortunately, this change in direction is taking place in a context of extreme political pressure, and a controversial appointment to succeed Powell, due to be announced this Fall, would likely cross the line. To be continued but, for now, it is not clear that the Fed's actions are guided by anything other than its mandate, regardless of what the U.S. president thinks

Global Asset Allocation Views

Asset Classes	-		N		+
Equities	☐	☐	☐	☒	☐
Fixed Income	☐	☒	☐	☐	☐
Cash	☐	☐	☒	☐	☐
Alternatives	☐	☐	☐	☒	☐
Fixed Income					
Government	☐	☒	☐	☐	☐
Credit	☐	☐	☐	☒	☐
Duration	☐	☐	☒	☐	☐
Equities					
Canada	☐	☐	☐	☒	☐
United States	☐	☒	☐	☐	☐
EAPE	☐	☐	☐	☒	☐
Emerging Markets	☐	☐	☒	☐	☐
Alternatives & FX					
Gold	☐	☐	☒	☐	☐
Uncorrelated Strategies	☐	☐	☐	☒	☐
Canadian Dollar	☐	☐	☒	☐	☐

CIO Office

Bottom line: While the list of potential reasons is long for a stock market pullback in the short term, the upward trend should remain dominant supported by earnings growth and more accommodative policy stances. By comparison, bond markets already seem to be pricing in a number of rate cuts over the next year, leaving little room for sizeable gains.

Market review

Fixed income

- › The Canadian fixed-income universe remained relatively unchanged in August, with gains in the short- and medium-term segments offsetting losses within long-term bonds.
- › U.S. Treasuries posted monthly gains as bond yields fell following Jerome Powell's Jackson Hole speech, with the Fed Chair signaling that the central bank was open to resuming its rate-cutting cycle.

Equities

- › Global equities posted modest gains in August, with Canada and the EAFE region slightly outperforming. Emerging Markets underperformed, dragged down by Indian equities suffering from trade tensions with the United States.
- › Within U.S. equities, Russell 2000 small caps stood out with a solid monthly outperformance against the S&P 500. This highly cyclical, interest-rate-sensitive segment benefitted from the resilience of the U.S. economy and the Fed's more dovish stance.

FX & Commodities

- › Gold prices posted significant gains in August, while oil prices fell sharply linked, among other things, to OPEC+ prematurely ending its production cuts.
- › Following a rebound in July, the U.S. dollar returned to its downward trend, with the DXY Index posting a 2% decline in August. The prospects of a more dovish Fed weighed on the Greenback.

Market Total Returns

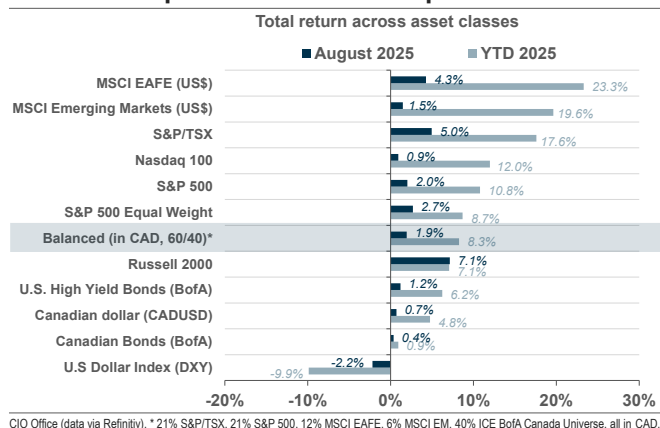
Asset Classes	August	YTD	12M
Cash (S&P Canada T-bill)	0.2%	1.9%	3.4%
Bonds (ICE Canada Universe)	0.4%	0.9%	2.7%
Short Term	0.6%	2.6%	4.6%
Mid Term	0.9%	2.5%	4.0%
Long Term	-0.5%	-3.0%	-1.3%
Federal Government	0.5%	1.0%	2.1%
Corporate	0.2%	2.4%	5.7%
U.S. Treasuries (US\$)	1.0%	4.4%	2.2%
U.S. Corporate (US\$)	1.0%	5.4%	4.2%
U.S. High Yield (US\$)	1.2%	6.2%	8.1%
Canadian Equities (S&P/TSX)	5.0%	17.6%	25.9%
Communication Services	4.4%	15.0%	-4.1%
Consumer Discretionary	0.7%	17.0%	20.4%
Consumer Staples	-0.8%	5.4%	10.6%
Energy	4.0%	10.9%	16.3%
Financials	4.3%	17.2%	32.3%
Health Care	9.2%	-3.9%	6.0%
Industrials	0.0%	5.4%	6.3%
Information Technology	6.2%	17.3%	50.2%
Materials	15.9%	50.8%	48.2%
Real Estate	3.7%	12.2%	6.0%
Utilities	0.3%	13.1%	18.2%
S&P/TSX Small Caps	9.3%	25.1%	30.8%
U.S. Equities (S&P 500 US\$)	2.0%	10.8%	15.9%
Communication Services	3.6%	17.9%	34.3%
Consumer Discretionary	3.4%	2.0%	24.8%
Consumer Staples	1.6%	5.5%	3.0%
Energy	3.6%	7.5%	2.1%
Financials	3.1%	12.6%	19.9%
Health Care	5.4%	0.8%	-11.1%
Industrials	0.0%	16.1%	17.3%
Information Technology	0.3%	14.0%	22.5%
Materials	5.8%	11.6%	0.3%
Real Estate	2.2%	5.7%	0.5%
Utilities	-1.6%	13.0%	13.8%
Russell 2000 (US\$)	7.1%	7.1%	8.2%
World Equities (MSCI ACWI US\$)	2.5%	14.7%	16.3%
MSCI EAFE (US\$)	4.3%	23.3%	14.5%
MSCI Emerging Markets (US\$)	1.5%	19.6%	17.7%
Commodities (GSCI US\$)	-0.2%	5.4%	9.3%
WTI Oil (US\$/barrel)	-8.5%	-11.2%	-13.6%
Gold (US\$/oz)	4.4%	31.1%	37.4%
Copper (US\$/tonne)	2.7%	13.5%	7.7%
Forex (US\$ Index DXY)	-2.2%	-9.9%	-3.9%
USD per EUR	2.3%	13.0%	5.7%
CAD per USD	-0.8%	-4.4%	1.9%

CIO Office (data via Refinitiv, as of 2025-08-29)

Back to school

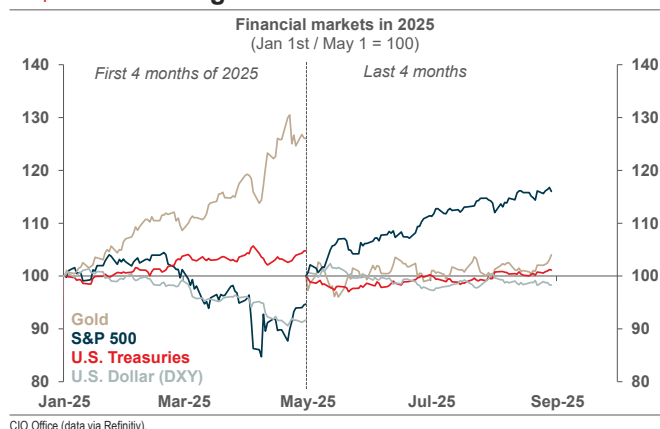
With Summer drawing to a close, there's no denying that the hot season has been rather clement for equity markets, which extended their annual gains for a fourth consecutive month in August (**Chart 1**).

1 | Another positive month for equities...



Moreover, while equities rallied, the rest of the financial markets seemed literally to have gone on vacation over the past four months with gold prices, Treasury bills, and the U.S. dollar all relatively unchanged over the period. This is quite a contrast to the first four months of the year (**Chart 2**).

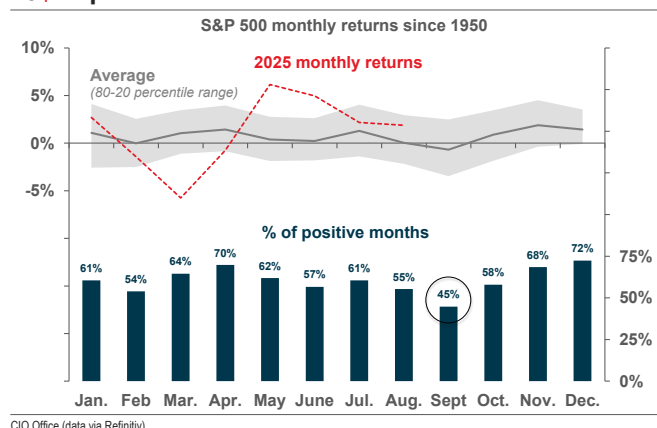
2 | ... concluding a clement summer on the markets



Now, although this positive outcome for equities is broadly in line with — and even exceeds — our

expectations,¹ we should not be under any illusions. The longer the period of low volatility lasts, the greater the chances of a sudden and unexpected increase in risk which often occurs in September, the month with historically the lowest average returns (**Chart 3**).

3 | September rain?



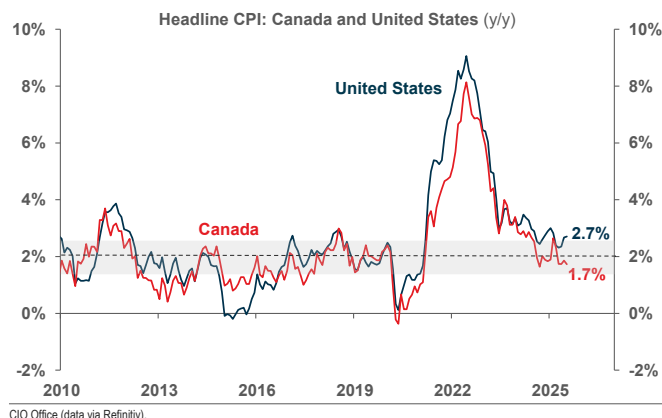
In this context, let's first review the key factors to monitor over the coming months, before concluding with the implications for the markets and our asset allocation strategy.

¹ For more details, see our [report dated June 2, 2025](#), in which we introduced changes to our asset strategy, involving a shift to a more pro-risk stance in light of decreased economic uncertainty.

To watch this Fall

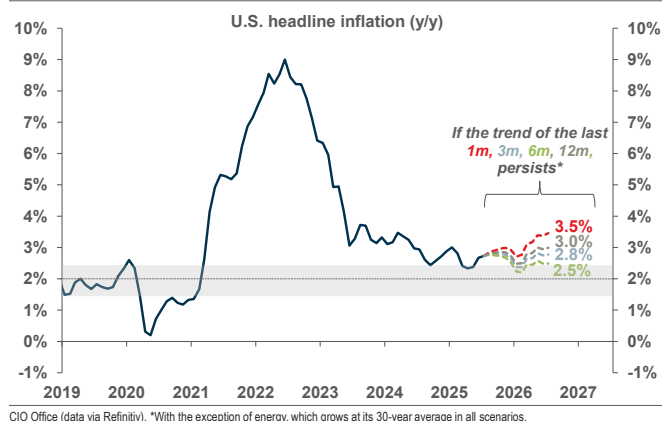
While Canada's headline annual inflation remains close to the 2% target, in the U.S., progress still seems to be stagnating around 3% (**Chart 4**).

4 | More of the same for inflation...



Furthermore, recent trends — which now cover the imposition of tariffs — suggest that a return to target over the next year remains unlikely south of the border (**Chart 5**).

5 | ... stuck above the target in the U.S.?



Nevertheless, although this situation is certainly not ideal and requires constant vigilance, it must be recognized that it is not as dramatic as some feared six months ago, when new tariffs were first introduced.

In this regard, a team from Harvard University recently developed daily consumer price indices based on online data from four major U.S. retailers, broken down by country of origin.² The main conclusion: Although prices for goods rose rapidly after tariffs were imposed (even for locally produced goods), the magnitude of the adjustments remains relatively modest compared to the announced tariffs (click here for updated price indices, **Chart 6**). This is consistent with comments made by Walmart and other retailers during the earnings season.

6 | Widespread but moderate increase in prices...

HBS Pricing Lab Tariff Tracker: Daily price indices of U.S. retail goods sold (Goods sold by four major U.S. retailers*, Oct 1st 2024 = 100)

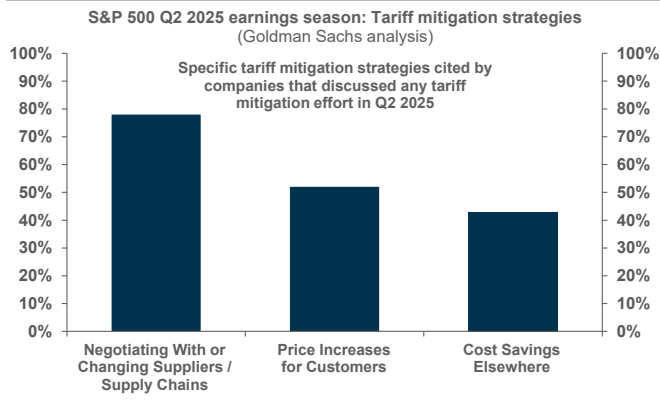


Furthermore, an analysis by the Goldman Sachs research team revealed that only about half of the S&P 500 companies that discussed the impact of tariffs on their earnings said they had passed on at least some of the price increases to consumers, with the vast majority opting instead to negotiate — or even change — their suppliers (**Chart 7**, next page).

Overall, it may therefore come as no surprise that, for the first time since May 2021, small businesses in the U.S. are no longer more concerned about inflation than about weak sales (**Chart 8**, next page).

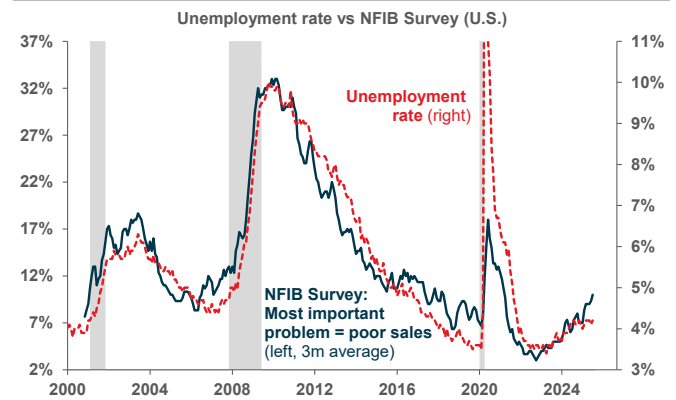
² Tracking the Short-Run Price Impact of U.S. Tariffs (Cavallo, Llamas, Vasquez, 2025).

7 | ... as businesses adapt as best they can



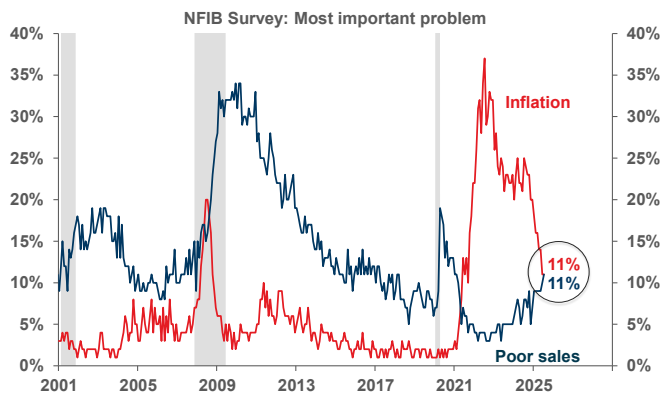
CIO Office (data via Goldman Sachs Global Investment Research).

9 | ... putting the job market at risk...



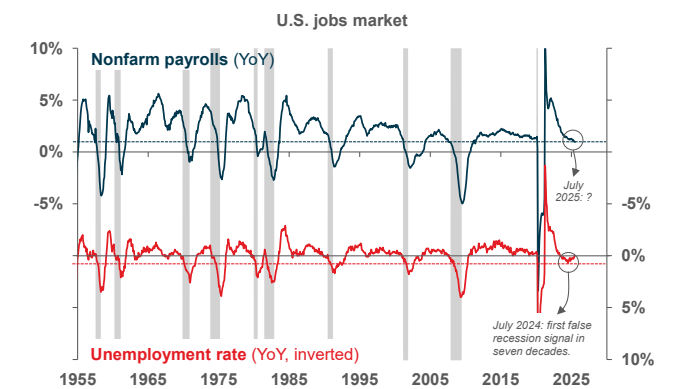
CIO Office (data via Refinitiv).

8 | Times are changing...



CIO Office (data via Refinitiv).

10 | ... which is (still) slowing down



CIO Office (data via Refinitiv).

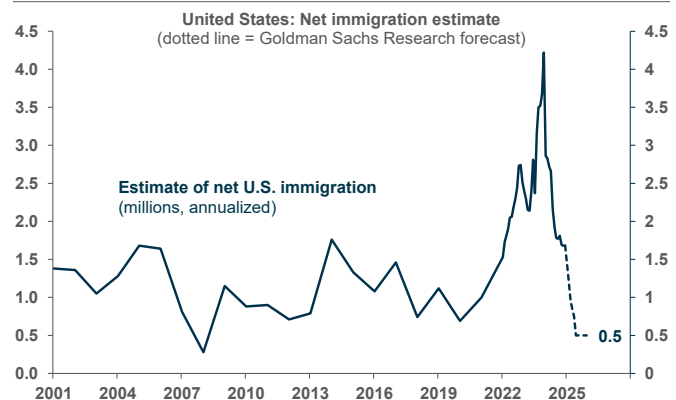
This changing dynamic is not insignificant, considering that challenging sales often lead to layoffs and, consequently, an increase in the unemployment rate (**Chart 9**).

As a result, it will be particularly important to monitor developments in the labour market over the coming months, having recently slowed down to below 1% annual employment growth, a situation historically synonymous with recession (**Chart 10**).

That said, there is no need to panic. First, many of the previously flawless recession signals have proven to be misleading in recent years. Second, with the slowdown in the growth of the working-age population resulting from the Trump administration's

immigration policies (**Chart 11**), it is entirely expected that the number of jobs created each month will also slow down, without this necessarily indicating an imbalance. Finally, overall, labour

11 | Population growth is also slowing down



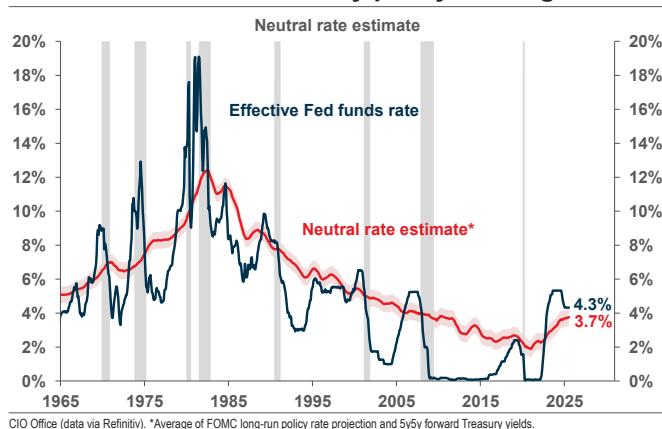
CIO Office (data via Goldman Sachs Research, Department of Homeland Security, CBO).

market indicators (unemployment rate, unemployment insurance claims, layoffs, job openings, etc.) remain positive. Nevertheless, against this changing backdrop, it was becoming increasingly difficult for the Fed to justify maintaining a restrictive monetary policy.

Pivot under pressure

The Fed's next interest rate decision is on September 17, and chances seem high (84% according to the markets) that Jerome Powell will announce his first rate cut since December 2024, marking the beginning of a gradual shift toward a neutral monetary policy (**Chart 12**).

12 | A more neutral monetary policy is in sight



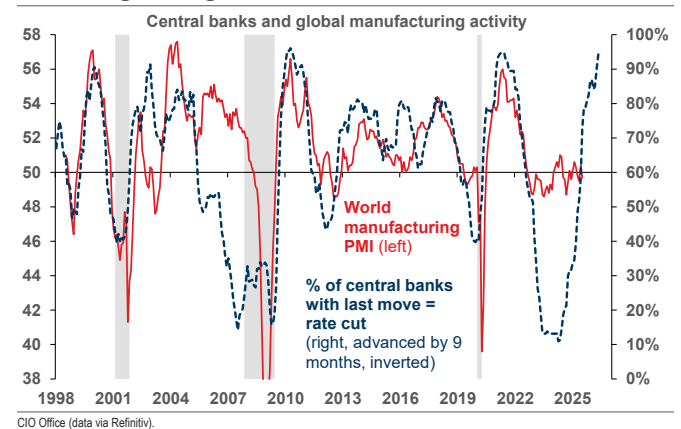
Unfortunately, this change in direction is taking place in a context of extreme political pressure, with the U.S. president leaving little room for interpretation about his intentions by stating that he “will have a majority very soon,” referring to the monetary policy committee composed of seven governors, three of whom are already relatively aligned with his administration's outlook (Bowman, Waller, and the newly appointed Miran), and one (Cook) who has to fight her firing in court.³ Playing

with the Fed's independence is probably the closest thing to playing with fire in economic terms, and a controversial appointment to succeed Powell, expected to be announced this Fall, would likely cross the line.

To be continued but, for now, it's not clear that the Fed's actions are guided by anything other than its mandate, regardless of what the President thinks.

Thus, the consequence of the few rate cuts on the horizon is likely to be positive for economic growth. In fact, virtually all central banks around the world have recently lowered their benchmark rates, which effectively suggests stronger global economic activity in the coming quarters (**Chart 13**).

13 | Will global growth bounce back?



By extension, this context could be supportive for equity markets. Already, corporate earnings have been surprisingly strong in the second quarter, with annual growth of 13.2% being more than twice as high as initially anticipated. In light of these results, analysts have been compelled to revise their forecasts upward for the next twelve months in almost all sectors (**Chart 14**, next page).

³ Trump says he'll have a Fed 'majority' soon to push rates lower after firing Cook, CNBC, August 26, 2025.

14 | Corporate earnings are strong...

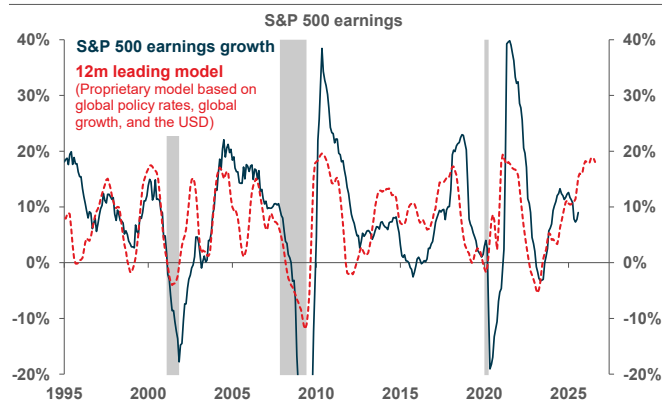
U.S. equities earnings

	Price index weight	Earnings weight (12m)	Q2-2025 (realized)		Next 12m (expected)	
			Growth	Revisions (3m)	Growth	Revisions (3m)
S&P 500	100%	100%	13.2%	▲ 7.1%	12.3%	▲ 1.4%
Technology	34%	27%	24.4%	▲ 6.5%	18.6%	▲ 1.5%
Health Care	9%	13%	8.7%	▲ 4.1%	10.5%	▼ -2.5%
Financials	14%	19%	13.9%	▲ 11.0%	10.3%	▲ 2.2%
Telecom. Services	10%	8%	48.8%	▲ 15.7%	4.6%	▲ 2.5%
Discretionary	11%	9%	7.0%	▲ 10.4%	10.2%	▲ 3.2%
Industrials	8%	8%	4.2%	▲ 1.8%	15.6%	▲ 1.3%
Energy	3%	5%	-18.5%	▲ 6.8%	5.9%	▲ 7.3%
Staples	5%	6%	0.7%	▲ 3.1%	4.6%	▲ 1.2%
Materials	2%	2%	-1.4%	▲ 3.4%	13.2%	▲ 4.7%
Utilities	2%	3%	-1.6%	▼ -0.7%	7.4%	▲ 1.1%
Real Estate	2%	1%	1.9%	▼ -0.7%	7.7%	▲ 3.5%

CIO Office (data via Refinitiv).

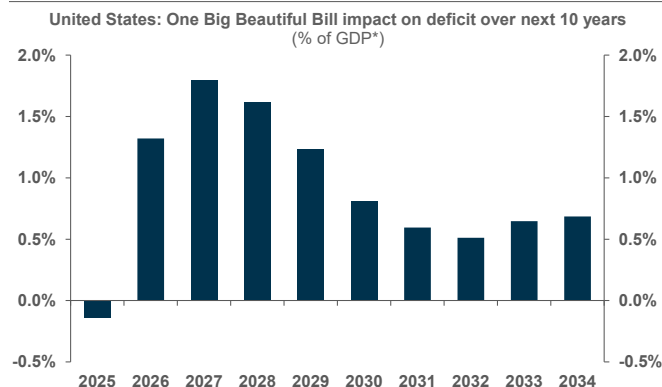
And while these expectations may seem optimistic, they do not appear so exaggerated when one takes into account certain factors such as the stance of central banks and a weaker U.S. dollar (Chart 15).... not to mention the U.S. fiscal stimulus that will really kick in, in 2026 (Chart 16).

15 | ... and the outlook is positive...



CIO Office (data via Refinitiv).

16 | ... with fiscal stimulus also in the pipeline



CIO Office (data via Penn Wharton Budget Model, CBO). *Using latest CBO forecast of U.S. GDP.

The bottom line

Between upside surprises on inflation, downside surprises on employment, attacks on the Fed's independence, or simply a classic "buy the rumour, sell the news" scenario following a rate cut in the U.S., the list of potential reasons for a stock market pullback is long.

Nevertheless, there is reason to believe that the upward trend will remain dominant, which is why we are maintaining our overweight position in equities.

Indeed, while the economy has faced its share of disruptive events in recent years, the decisive factor for the overall direction of the markets has often been the guidance provided by policymakers.

So, with tariff uncertainty easing and the Fed's more dovish intentions taking shape, the path of least resistance is likely to remain upward (Chart 17), especially as investor sentiment does not appear overly optimistic yet (Chart 18, next page).

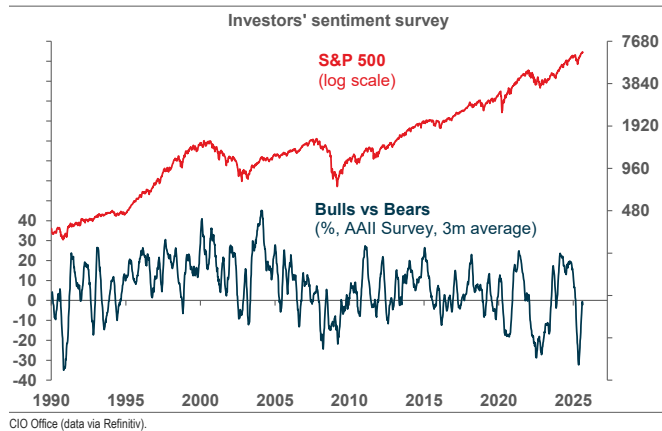
17 | Policy guidance is crucial



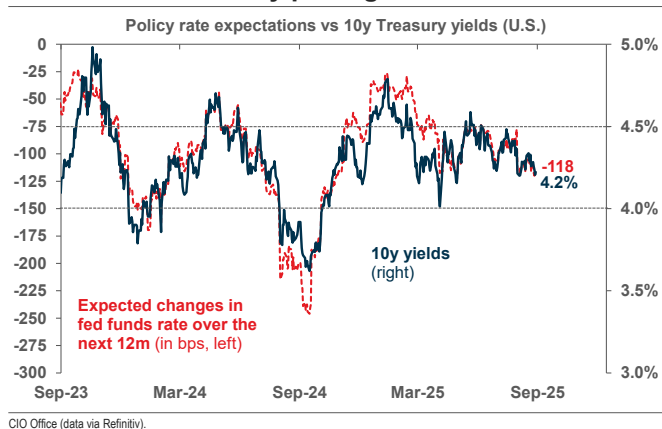
CIO Office (data via Refinitiv).

In comparison, the outlook for bonds is more mixed. At current levels, 10-year Treasury bonds already seem to be anticipating between four and five rate cuts over the next year (Chart 19, next page), which is probably the most the Fed could justify with

18 | Investor sentiment doesn't seem excessive

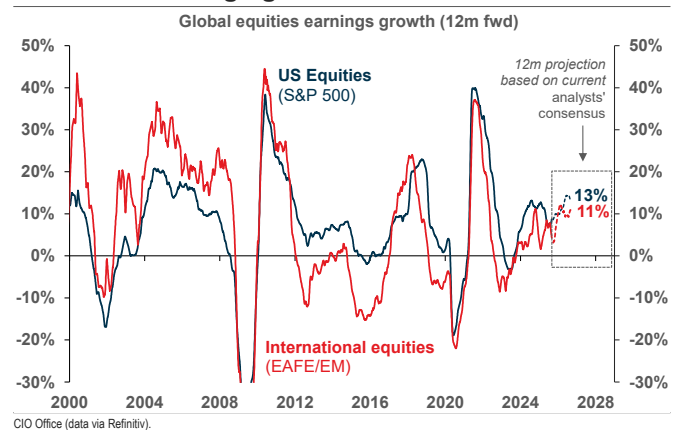


19 | Bonds are already pricing in several rate cuts

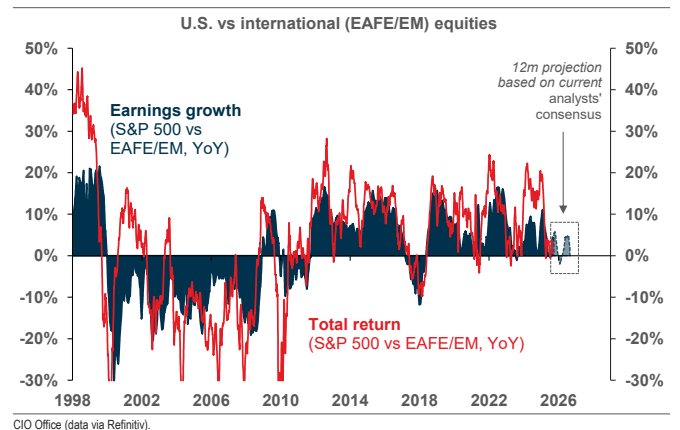


respect could eventually tip the scales in favour of U.S. equities.

20 | Better earnings growth...



21 | ... could continue to favor the S&P 500...



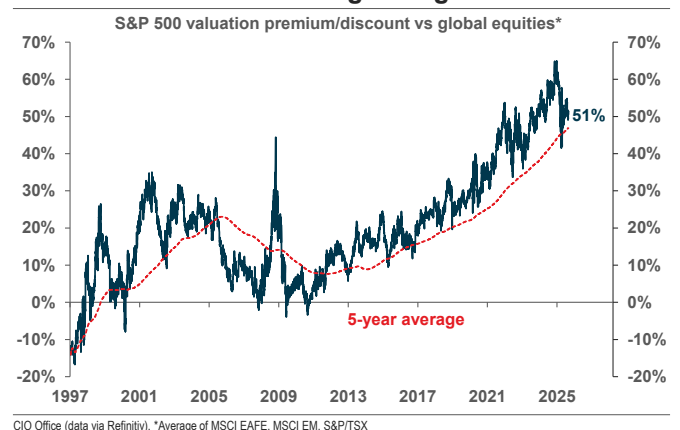
inflation slightly above target barring a significant rise in unemployment.

Finally, within equities, while the outlook continues to look more attractive outside the U.S., we do not rule out a return to a more favourable allocation toward the S&P 500 over the coming months.

With the latest earnings season, the S&P 500's profit growth outlook has strengthened relative to the rest of the world (**Chart 20**), a key factor in determining regional leadership in equities (**Chart 21**).

For now, it is far from clear that this expected advantage justifies such a significant valuation premium (**Chart 22**), but a better balance in this

22 | ... but it's far from being a bargain



CIO Office
CIO-Office@nbc.ca

Martin Lefebvre
Chief Investment Officer
martin.lefebvre@nbc.ca

Louis Lajoie
Senior Director
Investment Strategy
louis.lajoie@nbc.ca

Simon-Carl Dunberry
Senior Director
Portfolio Strategy
simon-carl.dunberry@nbc.ca

Nicolas Charlton
Director
Quantitative Strategy
nicolas.charlton@nbc.ca

Mikhael Deutsch-Heng
Director
Investment Strategy
mikhael.deutschheng@nbc.ca

Zaid Shoufan
Associate
Portfolio Strategy
zaid.shoufan@nbc.ca

Julien Gordon
Analyst
Quantitative Strategy
julien.gordon@nbc.ca

General

The information and the data supplied in the present document, including those supplied by third parties, are considered accurate at the time of their printing and were obtained from sources which we considered reliable. We reserve the right to modify them without advance notice. This information and data are supplied as informative content only. No representation or guarantee, explicit or implicit, is made as for the exactness, the quality and the complete character of this information and these data. The opinions expressed are not to be construed as solicitation or offer to buy or sell shares mentioned herein and should not be considered as recommendations.

Views expressed regarding a particular company, security, industry, market sector, future events (such as market and economic conditions), company or security performance, upcoming product offerings or other projections are the views of only the CIO Office, as of the time expressed and do not necessarily represent the views of National Bank of Canada and its subsidiaries (the "Bank"). Any such views are subject to change at any time based upon markets and other conditions, which could cause actual results to differ materially from what the CIO Office presently anticipate(s) or project(s). The Bank disclaims any responsibility to update such views. These views are not a recommendation to buy or sell and may not be relied on as investment advice.

These index providers may be included in this document: BofA Merrill Lynch, Standard & Poor's, FTSE, Nasdaq, Russell et MSCI. These companies are licensing their indices "as is", make no warranties regarding same, do not guarantee the suitability, quality, accuracy, timeliness and/or completeness of their indices or any data included in, related to or derived therefrom, assume no liability in connection with their use and do not sponsor, endorse or recommend National Bank Investments Inc. and any of their products and services. The above index providers do not guarantee the accuracy of any index or blended benchmark model created by National Investment Bank using any of these indices. No responsibility or liability shall attach to any member of the Index Providers or their respective directors, officers, employees, partners or licensors for any errors or losses arising from the use of this publication or any information or data contained herein. In no event shall the above Index Providers be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, legal or other expenses, or losses (including, without limitation, lost revenues or profits and opportunity costs) arising out of or in connection with the use of the content, even if advised of the possibility of such damages.

The FTSE/TMX indices are trademarks of the LSE Group. S&P Indices are trademarks of S&P Dow Jones Indices LLC, a division of S&P Global. MSCI indices are trademarks of MSCI Inc. BofA indices are trademarks of Merrill Lynch, Pierce Fenner & Smith incorporated ("BofAML"). Nasdaq index is a trademark of Nasdaq Inc. Russell 2000 ® is a trademark of the Frank Russell Company.

© NATIONAL BANK INVESTMENTS is a registered trademark of National Bank of Canada, used under licence by National Bank Investments Inc.

© National Bank Investments Inc., 2025. All rights reserved. Any reproduction, in whole or in part, is strictly prohibited without the prior written consent of National Bank Investments Inc.

National Bank Investments is a signatory of the United Nations-supported Principles for Responsible Investment, a member of Canada's Responsible Investment Association, and a founding participant in the Climate Engagement Canada initiative.