Equitable
Asset Management Group

Investment Playbook

Equitable Life Active Balanced Portfolios – Q3 2016

Content

Global economic outlook
Asset class outlook

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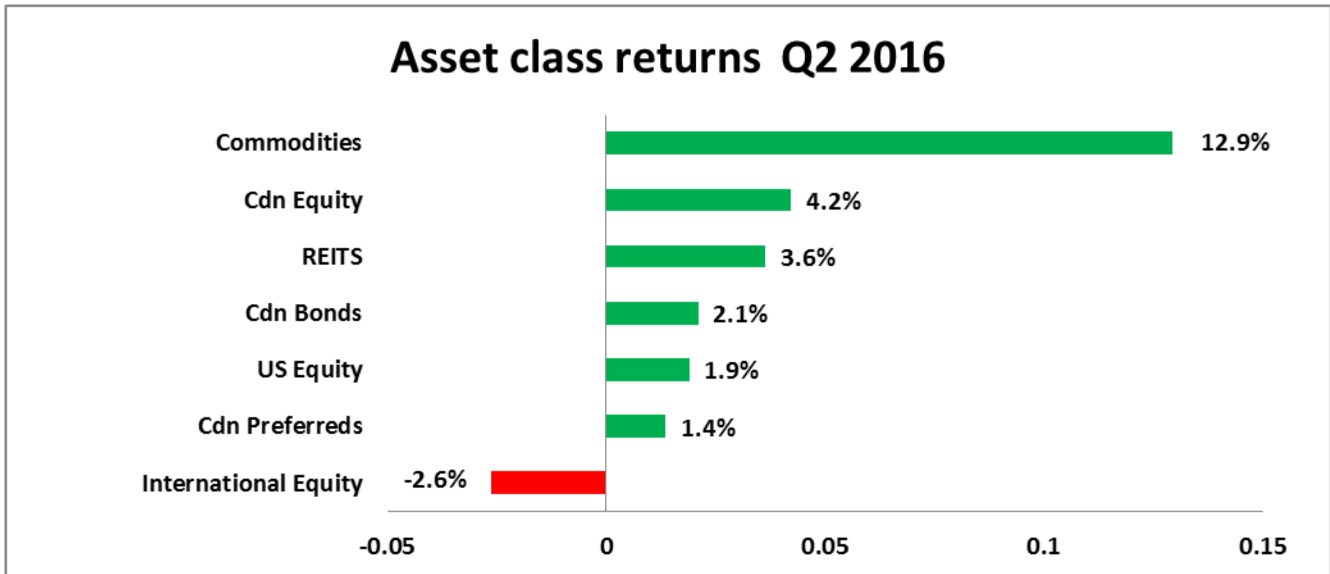

Source: Bloomberg, as of 06/30/2016

Global backdrop **(Negative)**

- The secular backdrop remains weak, and the recent Brexit results are contributing to the economic uncertainty overseas. As well, the potential impacts to North America remain largely unknown.
- Europe remains an area we closely watch as Brexit has potentially catalyzed the beginnings of the breakup of the European Economic and Monetary Union. While this is not our base case, the risk of this has increased.
- We are closely watching the 2017 German and French elections as potential signposts of further deterioration of the political backdrop.
- Exacerbating the political risks is an impaired banking system, in particular in Italy where non-performing loans make up close to 20% of GDP.
- Adding to these concerns are aging population bases across developed nations that will be challenged to manage extremely high debt-to-GDP ratios.
- While still considered an emerging nation, China currently contends with these demographic challenges coupled with high debt levels, both acting as significant headwinds to an already slowing economy.
- And at 15% of Global GDP, a slowdown in China could have significant ripple effects across the global landscape, particularly those economies closely tied to commodities.

US economy **(Positive)**

- Despite the concerning global conditions, the US consumer is relatively healthy which should help support the broader economy. With job growth slowing but remaining on a positive course, and wage growth remaining solid at 2.5%, consumer confidence remains solid.

- There has been marked improvement in consumer balance sheets and, with many seeing positive equity values in their homes, consumers are becoming more comfortable with re-leveraging their balance sheets.
- As a result, we expect that consumer spending will accelerate over the coming year, back up to a 2% contribution to GDP growth.
- We believe the contraction that has been occurring in trade is in the rear view mirror as the USD has stabilized; as such this should become a less negative factor over the coming quarters.
- Based on the above, we expect US GDP growth of 2.5%.

Canadian economy (Neutral)

- While the risks in the energy patch have not completely disappeared, there has been some improvement in supply-demand forces. Based on this we believe much of the commodity contraction is behind us.
- Central Canada has seen solid growth which has helped consumer confidence across these markets, although Western Canada remains weak.
- As well, the housing market has held up very well, but we do anticipate this will flatten out in the coming quarters.
- Diminishing growth in trade from a weakened Canadian dollar, however, will offset much of the improvement we've seen in consumer spending.
- Based on the above, we expect overall Canadian growth over the next four quarters to deliver 1.65%.

Asset class outlooks

Government bonds (Neutral)

- Rates are making new all-time lows and will continue to be challenged to move materially higher from current levels.
- The risk environment remains elevated quarter-over-quarter, with the global growth outlook becoming increasingly fragile. Brexit has added another impediment to global growth and more ambiguity to the future of the EU.
- Deflationary risks in North America have largely abated but a stronger USD still remains a headwind; commodities show signs of stability as global supply/demand dynamic potentially enters early stages of a rebalance.
- Divergent Canadian/US monetary policy no longer presents an issue. Both central banks are likely on the sideline for longer. Flows into government debt markets will likely see a material pickup in the hunt for yield, as sovereign yields in both the US and Canadian market look attractive from a global perspective.
- Global monetary policy will remain accommodative, as the European Central Bank and the Bank of Japan continue to introduce aggressive monetary policy actions and the Bank of England has moved from on hold to adding stimulus post the British referendum. Developed deleveraging and the unfavourable demographic backdrop of aging populations will continue to keep interest rates low for some time.

- The resulting fixed income environment will see yields struggle to move materially higher from current all-time lows but we expect volatility to remain high. Canada will continue to be supported by a gravitational pull of lower global bond yields.

Corporate bonds (Neutral)

- Our current views of the credit market remain negative over the long-term as weakening balance sheets and poor credit metrics in North American corporations are expected to persist for the next year.
- The macro global environment is in a fragile state that will become more susceptible to event risk as central banks continue to maintain low interest rates and embark on further quantitative easing programs.
- On a shorter term basis, equity investors are starting to show signs of displeasure towards slowing buybacks and a slowing M&A market which could become positive for corporate bonds as companies begin to deleverage.
- The demand for credit remains very healthy, supporting prices as there was a material reduction in new issuance in the first half of the year. The sluggish growth that is expected to continue justifies an underweight over the long term; however, the short term supply and demand imbalances will prevent material weakness unless driven by an event.
- Unchanged from the last review, we have less preference for BBB-rated corporates and cyclical sectors. We favour the issuers with higher credit quality in each sector. We also prefer to maintain flexibility in finding tactical opportunities to reduce risk on rallies.

Equities (Neutral)

- Our equity market outlook has improved over the past quarter as indications surface of a potential bottoming in US corporate fundamentals. In particular, relative improvement in the manufacturing sector points to improving topline growth on the S&P 500.
- Retail sales look supportive of revenue growth in the coming quarters as consumer confidence continues to trend positively. Strengthening wage data and a generally strong labour market support an improving outlook for the consumer. Based on this, we could see strength in the back half of 2016 providing a catalyst for positive S&P 500 returns.
- In addition to improving corporate earnings, investors' expectations of increased central bank accommodation should offer support to equities. Because of the low yield environment, equities offer an attractive alternative for yield seeking investors.
- Still, valuations remain high and are at the second most expensive period in history, which increases potential downside risks.
- This aside, US markets offer the best balance of risk and reward. A generally stable macro environment, coupled with an improving corporate environment could provide the backdrop US equity investors require. Based on this, a neutral equity position relative to fund assets is justified.

- While the US offers the best balance of risk and reward, Canada contains more macro risks and therefore remains less favoured relative to the US.
- International equities remain our least favoured region. In particular, Europe's systemic issues including vulnerabilities surrounding the Brexit outcome and a challenged banking system highlight the significant risks to positions in the European Market. As well, the Bank of Japan continues to struggle after decades of ineffectual monetary policy with little prospect of a positive resolution in the near term.

REITS (Neutral)

- The first half of 2016 has proven to be challenging for investors. After declining through January and the first half of February, REITs rebounded to the end of first quarter. Since this time, prices have been range bound.
- Underlying real estate fundamentals and low interest rates are likely to remain supportive of REITs throughout 2016.
- Potential headwinds related to a rise in interest rates have dissipated now that the US Federal Reserve has taken a more dovish tone.
- With respect to Brexit, REITs are not affected to any large degree from a fundamental perspective.
- In terms of our REIT holdings, the US is the largest regional position at 63% of our REIT exposure while the UK remains below 5%.
- Post the Brexit vote, REITs were caught up in the immediate decline witnessed in broader equity markets but have since rebounded and are now trading at their highest levels since early 2015.
- Based on the decent real estate fundamentals we remain neutral in our REIT positioning.

Equitable Life Active Balanced Portfolios Q3 positioning

Asset class	Benchmark relative weight*	Previous weight
Cash	**Neutral**	**Neutral**
Government bonds	**Neutral**	**Neutral**
Corporate bonds	**Neutral**	**Underweight**
Equity	**Neutral**	**Overweight**
Canada	**Overweight**	**Underweight**
Us	**Overweight**	**Overweight**
International	**Underweight**	**Overweight**
Global Real Estate	**Neutral**	**Neutral**

EAMG Investment philosophy

The Equitable Asset Management Group investment philosophy follows an asset allocation model, which differs from the more prevalent stock selection approach to asset management. To guide us in our asset class decisions, we employ a macro-driven, top-down investment philosophy which we believe minimizes risk and maximizing returns across the entire asset class spectrum. Our insurance based background offers a conservative and measured approach to return generation that seeks to grow client wealth in a safe and responsible manner.

*Negative, neutral and positive ratings indicate current, not full year views

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