Equitable
Asset Management Group

Investment Playbook

Equitable Life Active Balanced Portfolios – Q4 2016

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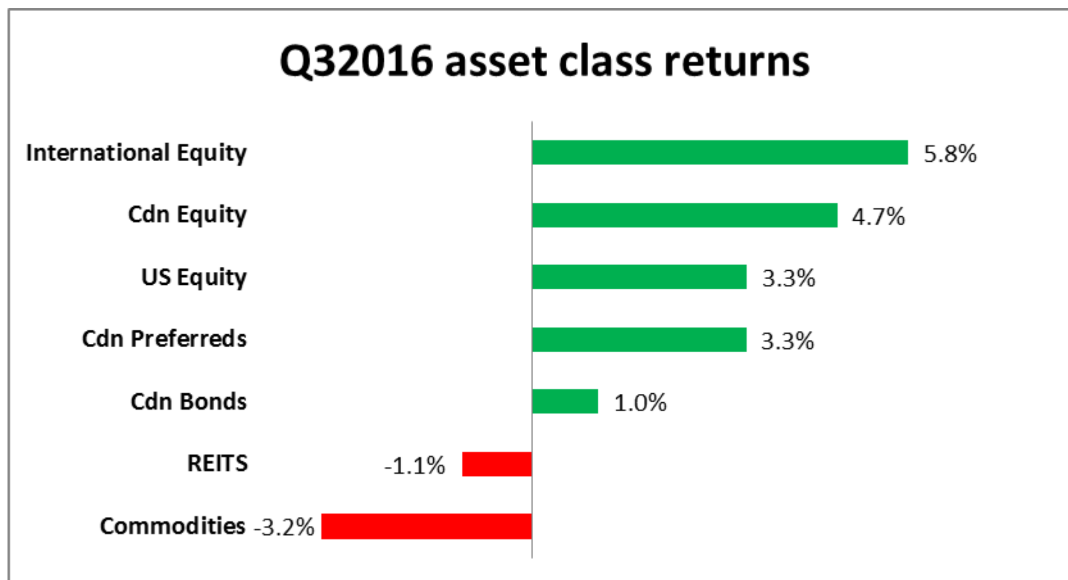

Source: Bloomberg, as of 12/31/2015

Economic outlook

- Our one year forward looking US GDP expectations of 2.3% have come down marginally quarter over quarter, primarily from supply side housing constraints. The housing market has been suffering from a labour shortage and wage pressures. Over time, this should result in upward price pressures in the market and, as a result, an improvement in housing supply.
- This will take time however, particularly as experienced workers that have moved on to other markets after the 2008 correction are reluctant to come back into the construction market despite wage incentives.
- Our outlook for Canadian GDP growth is lower than the US at 2.0%, and generally in line with consensus forecasts, although we remain more bullish on the Canadian consumer and attribute less to the government sector. Our bullishness for Canadian consumer growth comes in part from government programs, such as the child tax benefit.
- International economies continue on their low growth trajectory. Concerns surrounding the impacts of slow growth in China have stabilized for the time being. This is largely thanks to continued infrastructure spending on the part of the Chinese government.
- Despite the near term stability, we see a chance of a cyclical correction over the mid-term as a result of over-capacity in many areas of the Chinese economy. The centralized government is attempting to undertake this action, but its success is questionable.

- Despite a stable fundamental backdrop in the European Union compared to recent years, the risk environment remains volatile as Italian banks continue to struggle with high non-performing loans, the Greek situation has not been resolved, and uncertainty over Brexit and the probability of follow-on referendums continues to simmer on the back burner. Much of this has been kicked down the road – with the market generally in a wait and see mode.
- With upcoming elections in France and Germany, the governments are likely to do what they can to keep these issues out of the headlines, but this doesn't change the instability of the current situation.
- Overall, we see a base case of slow but stable growth with the risks tilted to the downside. With economic growth at such low levels, and central bank policy already very simulative, the ability to stimulate growth should negative shocks occur is limited.

Asset class outlook

Government bonds (Neutral)

- Rates are making new all-time lows and will be challenged to move materially higher from current levels.
- Risks remain elevated since last quarter as the trajectory of global growth remaining fragile. Brexit has added another impediment and more ambiguity to the future of the EU.
- On the monetary policy front, there are increased expectations and probability of policy action from international central banks in the coming months. There is, as well, a growing appetite for further fiscal stimulus globally.
- North American deflationary risks have decreased but the stronger USD remains a headwind to growth. Commodities show signs of stability as global supply/demand dynamic potentially enters early stages of a rebalance.
- Sovereign yields in both the US and Canadian markets look attractive from a global perspective. Risk to further policy stimulus in North America is possible but not our base case scenario.
- Capital flows into Canadian government debt markets continue as investors continue to seek yield; therefore, any increase in the supply of bonds by the government to fund stimulus programs will easily be absorbed by investors and therefore supportive of prices.
- Global monetary policy is expected to remain accommodative as the European Central Bank and the Bank of Japan continue to push aggressive monetary policy. As well, the Bank of England moved from on hold to adding stimulus. Developed world deleveraging and the demographic backdrop will continue to keep interest rates low for the time being.

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

Corporate bonds (Neutral)

- Our long term view on corporate bonds remains negative given the weak fundamentals and poor credit metrics we are seeing in North America. We expect this environment to continue for the next 12 months. The global macro environment as well remains in a fragile state but in balance thanks to low interest rate policies.
- While we maintain a cautious stance on corporate bonds, a potential trend of corporate deleveraging could become positive for investment grade credit as companies refocus their use of cash.
- The market continues to be very responsive to the supply of corporate bonds with companies in Canada benefiting from the impact of low yields in European credit markets.
- The corporate bond buying programs introduced by the ECB and BofE have tightened spreads in each market. While longer-term we have a cautious view of the credit market, the sluggish growth that is expected to continue should keep central banks accommodative and help support credit bond prices.
- Unchanged from the last review, we have less preference for BBB-rated corporates and cyclical sectors and select the issuers with higher credit quality in each sector. We also prefer to maintain flexibility in finding tactical opportunities to reduce our holdings market on rallies.

Equities (Neutral)

- While global economies struggle for growth, the fundamental case for equities remains weak. Combined with high valuations, there appears to be little margin of safety in developed equity markets.
- With fundamentals weak and markets generally trading at a premium, equity markets are dangling on global central bank policies of low interest rates. This has largely been the case since 2008 and therefore seems to be losing some credibility given the lack of economic results.
- The S&P 500 is no different from global markets as it struggles with low growth and high valuations.
- The duration of the current bull market (second longest on record) in the US suggests markets are tired with risk weighing to the downside. Markets appear to be defying gravity, however, due largely in part to a lack of investment alternatives. Based on the lack of alternatives, we now have a neutral view on US equities.

- Canadian equities, which have surprisingly dominated the S&P 500 year-to-date, offer more risk than their US counterparts. Driving the rally in the first half of the year were commodities, namely oil and gold.
- On a quarter-to-date basis, banks have been amongst the top performers on the TSX and have picked up where commodities left off. The fundamentals of banking have held up well, despite the perceived risks. We keep a positive view on Canadian banks.
- Our view of commodities, in particular the energy market, offsets our relatively positive view of the banking landscape, which leads us to an overall negative view of the S&P/TSX Composite. Based on this, we remain underweight Canadian equities.
- Much like Canadian equities, our view of international developed equities remains negative due to significant risks in Europe as we approach the Italian referendum, as well as potential volatility from German and French elections. The geopolitical risk backdrop is offset somewhat by reasonable valuations which trade at a discount to North American markets and offers potential upside opportunity. The balance of these forces leads us to neutral view of international equities.

Real Estate Investment Trusts (REITs) - (Neutral)

- While underlying real estate fundamentals remain solid, revisions to rent growth expectations and stabilizing vacancies are muting expectations for a repeat of the strong returns seen over the past several years.
- REIT volatility is, as well, being driven by the prospects of an interest rate increase later in the year which would make higher yielding assets look less attractive. On a year-to-date basis, the MSCI US REIT Index is up 12.6% while the Dow Jones Global Select Real Estate Securities Index was up 8.5%. In contrast, the S&P500 is up 7.8% over the same time frame.

Current positioning - 09/30/2016

Asset class	Current weight	Previous weight
Cash	**Neutral**	**Overweight**
Government bonds	**Neutral**	**Overweight**
Corporate bonds	**Neutral**	**Underweight**
Equity	**Neutral**	**Underweight**
Canada	**Underweight**	**Underweight**
US	**Overweight**	**Underweight**
International	**Neutral**	**Neutral**
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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