Equitable Life of Canada®

Asset Management Group

INVESTMENT STRATEGY

2014 Strategy

Content

Tara Proper, CFA – AVP Capital Markets
Derek Vinke, CFA – AVP Quantitative Investment and Portfolio Risk
Dan Lavric, CFA – Director Credit Portfolio Management
David Irwin – Director Portfolio Management and Client Relations
Kevin Osborne, MBA – Portfolio Manager

Asset Class Strategy

Equitable Asset Management's Asset Class Positioning Biases

Asset Class	Benchmark Relative Weight*	Previous Weight
Cash	Neutral	Neutral
Fixed Income	Underweight	Underweight
Duration	Underweight	Underweight
Credit	Overweight	Overweight
Equities	Overweight	Overweight
Canada	Neutral	Overweight
US	Underweight	Overweight
International (Europe / Asia)	Selectively Overweight	Neutral
Global Real Estate	Neutral	Neutral
Other Asset Classes	Neutral	Neutral

**The stated positioning biases are relative to the benchmark allocation of the Equtiable Life Active Balanced Porfolio, and are reflective of the outlook for the year as at the time of writing. These positions may or may not reflect the current positioning of the fu nd.*

Equity Markets

United States

- Global economic fundamentals improved throughout 2013 and markets responded in-kind
- In the second half of the year a notable acceleration occurred in the S&P 500 relative to the economy
- This marked a shift in market sentiment as traders and investors placed increased emphasis on corporate fundamentals
- While corporate fundamentals have improved throughout 2013, most of the market rally has been driven by multiple expansion - the S&P 500 currently trades at 15.5x 2014 EPS estimates
- Going forward, consensus estimates anticipate 4-5% year-over-year revenue growth in 2014 driven by increased consumer activity, improving credit conditions and a strong housing market
- While corporate margins continue to defy gravity at recent historic highs, an improvement in the labour market and increased capital investment could reverse this trend
- We have not seen any significant uptick in business spending, although we believe increased capital expenditures and corporate hiring are imminent
- Continued positive market performance in 2014 for the US markets is limited due to high valuations, overly bullish investor sentiment and an absence of acceleration in revenue growth

Europe

- Europe looks favorable from a valuation standpoint, but the Eurozone's high deficits and weak economic outlooks do not make for a compelling case for continued investment
- Bright spots do exist however, in particular the UK which has better GDP growth expectations relative to the greater Eurozone
- 2014 has been marked as the transition year from the hope phase to the growth phase as investors look to the UK as a region with better relative investment opportunities
- Strong consumer confidence, manufacturing and a white-hot housing market should provide upside momentum for the consumer driven economy

Canada

- In Canada, revenue growth for 2014 is expected to accelerate to 5.4% from negative revenue growth in 2012 and 2013
- While strong earnings growth is also expected, economic headwinds in Canada are more pronounced compared to the US
- In Canada, anemic consumer growth, higher than expected unemployment, significant household debt, and a potential slowing in the housing market are all detracting investment factors
- Although this leads to a bearish view on the Canadian economy, most of this has been priced into the lagging Canadian equity market
- Potential market opportunities exist as the Canadian dollar continues to slide relative to the USD, which could stimulate exports and provide trading opportunities

Fixed Income

Government Bond Markets

- Bond yields are primarily driven by three components – inflation, economic growth and central bank policy
- Over the next few years the major drivers of interest rates will be moving in an upward trajectory, pushing yields higher
- We expect that over the next five years inflation will rise from the current, very low level, of just 1.2% in 2013, to 2.5%, pushing interest rates higher
- From an economic growth standpoint we also see risk to fixed income as Canada is more dependent on US growth from an interest rate perspective, therefore improving growth south of the border will place upward pressure on Canadian rates
- Central bank policy in the US is moving to reduce stimulus thereby removing some downward yield pressure, which is negative for bonds
- Yields on a 10-year bond, as a representation of the interest rate curve, will move up from the 2.5% rate at the end of 2013 to a low 3.0% level by the end of 2014

Corporate Credit

- Within the fixed income asset class, the case for corporate credit remains strong, particularly as an alternative to government bonds
- Corporate health remains solid, although no longer improving as an acceleration in dividend payments is offset by healthy corporate profit growth
- Demand for credit remains strong, accelerating into the end of 2013
- In particular, excess liquidity across the globe, loosening in lending standards, a low yield base and access to easy credit, are all leading to compressing risk premiums and excessive risk taking in the lower tiers of the corporate market
- Low government yields have motivated portfolio managers to increase exposure to credit to mitigate low discount rates against backdrop of rising yields
- For 2014, corporate spreads should continue to tighten modestly, and the higher yield on these assets should help credit outperform government bonds by 2.0-2.5%

Global Real Estate

- With the US economy poised to strengthen in 2014, rates will start to rise as the US central bank pulls back on its stimulus
- This will negatively affect REITs as they will be forced to refinance their debt at higher interest thereby reducing cash flows causing a resultant decrease in property values
- Over the longer term, the strengthening economy is a positive development as it will likely lead to lower vacancy rates and higher rents
- As a result the outlook for Global REITs is mixed, with short-term pressures offset by long-term opportunities

Conclusion

- The US economy has shown significant signs of improvement and the Canadian economy is on stable footing
- The economic stability reflected in market prices in 2013 will however challenge asset performance in 2014
- With an improving economy and reduced central bank stimulus, interest rates will slowly move higher
- Corporations are in good shape and so within the fixed income space corporate credit will outperform
- While equity performance will not be stellar, particularly by 2013 standards, we anticipate this will remain the best performing asset class in the near term

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