



Equitable Asset Management Group

ASSET ALLOCATION STRATEGY



Third quarter 2014 outlook

Content

Investment strategy

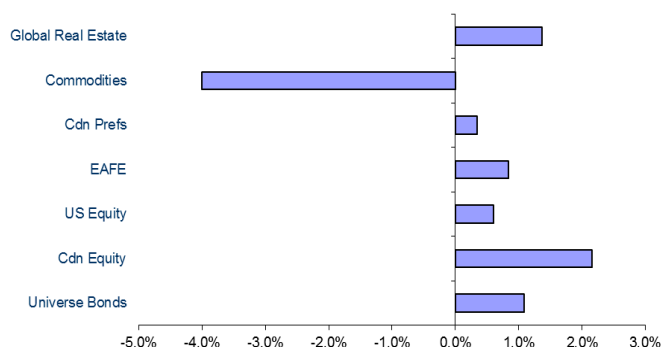
Economic outlook
Asset class outlook

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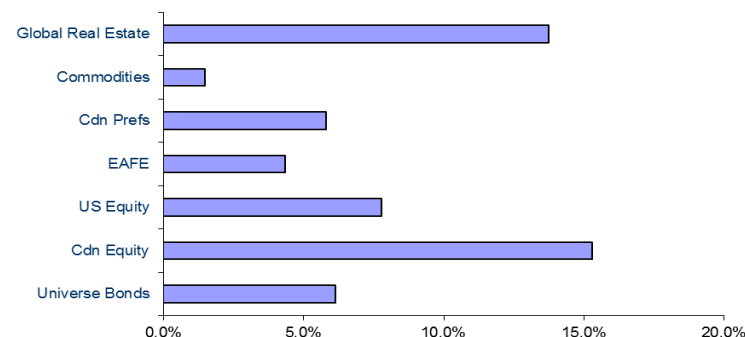
Asset Allocation

Asset Class Returns As of June 30th, 2014

Asset Class Returns QTD



Asset Class Returns YTD



(Source: Bloomberg, GSCI Commodity Index, S&PTX Preferred Share Index, MSCI EAFE Index, S&P500 Index, S&PTX Composite Index, Merrill Lynch Canada Bond Index)

Economic outlook

US

- Positive economic data including consumer spending and an improving job market continue to support the consensus view that Q1 weakness was based on temporary factors including weather.
- An improving labour market, strong equity market performance and the housing recovery have all had a positive effect on consumer confidence. In addition to an improving consumer, we expect businesses will begin investing in their operations once again, which has historically been a positive for the broader economy.
- Key economic indicators continue to move in the right direction and we expect will gain momentum throughout the year. As such, our full-year US GDP growth forecast remains a healthy 3.3%

Canada

- A slow-moving labour market and a highly indebted consumer challenge near-term growth prospects.
- This however, is offset by continued strength in the housing market, where resale data has reached levels across most major centers not seen since 2012. While housing affordability has decreased significantly, we do not believe this represents risks to the broader Canadian economy. Rising housing prices have had little impact on inflation readings with the consumer price index well contained at 2.3%.
- Net trade continues to improve on the back of a weaker dollar and a strong energy market should continue to contribute to economic growth for the remainder of the year.
- Our full-year Canadian GDP forecast remains in positive territory at 2.0%.

Asset class outlook**Government bonds**

- The US Federal Reserve continues to maintain its \$10 billion per meeting taper as the economy continues to improve.
- Review of the fundamental drivers of government bonds implies long-term yields in the US should be considerably higher based on our 3.3% GDP growth and 2.0% inflation forecasts. Despite this, we believe strong demand and central bank accommodation will keep yields 1.0% lower in the range of 3.0-3.5%.
- Canadian nominal yields will remain below US yields due to slower economic growth and higher consumer leverage. Based on the comparatively lower Canadian growth trajectory, we project Canadian yields will be in the 2.75-3.0% range

Corporate bonds

- Over the second quarter, both US and Canadian corporate bonds performed well with higher risk sectors outperforming more defensive sectors on a total return basis.
- Relative to provincial bonds Canadian corporates continue to offer more attractive opportunities. This has created a healthy issuance of new bonds which investors have welcomed.
- In terms of the market composition, we are seeing more risk taking by foreign buyers entering the Canadian corporate bond market as a means of diversifying portfolios away from their USD and EUR holdings.
- Corporate health indicators continue to reflect a positive environment for credit over the remainder of 2014, evidenced by a greater proportion of upgrades versus downgrades by ratings agencies. In addition to positive lending metrics, a lack of good fixed income alternatives continues to support positive credit market performance.
- While a significant portion of investor demand lies in the BBB rated space, the risks for taking on lower quality credit outweighs the current rewards. As such, we have increased our defensive sector exposure.
- Based on our views of continued corporate bond demand as well as a general improvement in the economy, we remain bullish on corporate bonds for the remainder of 2014.

Equities

- The main driver of equity markets continues to be highly accommodative monetary policies which has created a uniquely low-yield environment. This has created an environment where investors have been forced to take on more risk in order to generate reasonable yields.
- While valuations viewed in isolation appear expensive, we believe the current low interest rate environment continues to favour equities.
- In terms of corporate fundamentals, net profit margins on the S&P 500 remain in record territory and we expect the trend of lower costs and increased efficiency will continue to support profitability going forward. And as we enter the second quarter earnings season, we look for further confirmation that the improving economy will support corporate fundamentals.
- We believe the US equity market continues to offer the best risk-reward balance, followed by neutral views for Canadian and European equity markets.

Real Estate (REITs)

- Overall our views on real estate remain positive, which is reflected by strong year-to-date returns both in the US and in international markets. This strong performance is generally attributed to positive fundamentals as well as lower 10-year US treasury yields, which have fallen since the start of the year.
- With US GDP potentially poised to grow 3.3% for the remainder of 2014 and strong real estate fundamentals remaining front and center, REITs are in position to perform well over the remainder of the year.
- While REIT prices may be negatively influenced by sell-offs in 10-year treasuries, fundamentals remain too compelling to ignore. As such, we maintain a neutral stance on real estate.

Asset class positioning summary

Asset class	Benchmark relative weight*	Previous weight
Cash	Neutral	Underweight
Bond	Underweight	Underweight
Duration	Underweight	Neutral
Credit	Overweight	Overweight
Equity	Overweight	Overweight
Canada	Neutral	Neutral
US	Overweight	Overweight
International (Europe/Asia)	Neutral	Underweight
Global Real Estate	Neutral	Neutral
Other Asset Classes	Neutral	Neutral

*The stated positioning biases are relative to the benchmark allocation of the Equitable Life Active Balanced Portfolios, 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 fund.

The Equitable Asset Management Group investment style

There have been numerous studies which have demonstrated that the greatest contributor to a portfolio's overall return variance (opportunity) is asset class selection. As such, we focus our efforts on trying to determine which asset class offers our clients the best opportunity to generate risk-adjusted returns. To answer this question, the most effective investment style to employ is a macro-economic, top-down approach. We believe taking a big-picture, 10000-foot view of the investment landscape gives us a clear roadmap of the general direction of financial markets, and it is against this backdrop upon which we base our investment decisions. Gaining insight into broader economic themes such as labour markets, housing, global trade patterns and central banker policies helps us assess the potential impacts the economy will have on financial asset pricing. As the investment manager of Equitable Life of Canada's general assets, we employ relatively conservative views when approaching asset class investment decisions. This does not mean we do not take risks, but rather our investment decisions are made against rigorous and repeatable processes that seek to optimize the balance between potential risks and returns. We believe this risk-adjusted approach offers significant value for clients over the long-term.

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