Equitable
Asset Management Group

ASSET ALLOCATION STRATEGY

Fourth quarter 2014 outlook

Content

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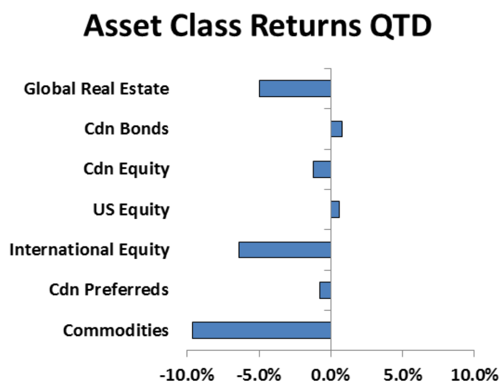
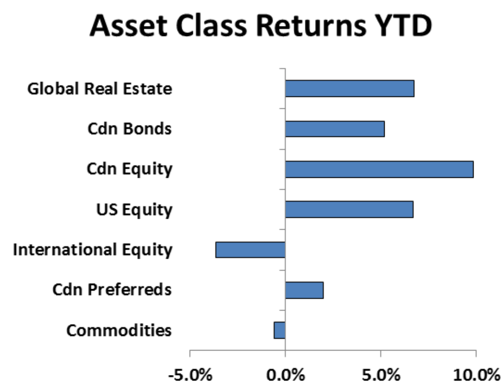
Asset Allocation

Asset Class Returns As of September 30th, 2014





(Source: Bloomberg, SPDR Dow Jones Global Real Estate ETF, GSCI Commodity Index, S&PTSX Preferred Share Index, MSCI EAFE Index, S&P500 Index, S&PTSX Composite Index, Bloomberg Canada Bond Composite Index)

Economic outlook
US

- Early indicators of the third quarter growth are progressing in line with our expectations, after a second quarter rebound in economic growth of 4.6% in the US and 3.1% in Canada.
- The second quarter rebound was on the back of a very weak, weather induced, first quarter (-2.1% and 0.9% respectively).
- We expect the forward four quarters to demonstrate solid economic growth. In the US, personal consumption will continue to drive economic growth off of strong consumer confidence and expanding credit.
- Business investment will also contribute almost 1% as CEO confidence improves and capacity utilization increases.
- The net contribution from the other sectors of the economy is expected to be a small positive.

Canada

- Canadian economic growth is expected to lag the US by almost one percent, with trade and the consumer driving growth.
- The Canadian consumer remains resilient, but will fall to only 50% of GDP in the coming year as households remain stretched.
- The weakened Canadian dollar and strengthening US economy will support net trade to keep the economy growing above 2%. This growth environment is supported by a stable international environment, although one that is showing some cracks in particular regions.
- We remain vigilant to the dynamics at play in emerging markets, the disinflationary pressures in Europe, and the weakening growth in China.

Asset class outlook

US government bonds (Negative)

- 10-year interest rates will move up from the current 2.30% level to the 3-3.5% range over the coming year.
- Our expectation is based on a solid fundamental backdrop, with trend growth over the cycle to average 2-2.5%. This trend GDP is about 1% lower than pre-2008 levels.
- Inflation will average 2% over the cycle, although with considerable risks to both the up and downside. Inflationary pressure from accommodative central bank policy is offset by a weak global backdrop, disinflationary demographic forces, and global deleveraging.
- This fundamental backdrop would suggest rates should be up over 4%. But central bank policy is unlikely to be as aggressive as the fundamentals would suggest, and the overnight rate will likely top out just above 3%. Each cycle, the ultimate overnight rate has been lower, and with the removal of QE providing a form of tightening this cycle is likely to continue this trend. As a result 10 year treasury rates will see resistance to moving above 3.5%.

Canadian government bonds (Negative)

- Canadian 10-year yields will rise to about 3%. Trend growth and inflation in Canada will be lower than in the US.
- The Bank of Canada is likely to hike rates less than the Fed, although starting from a level that is almost 1% higher.
- On the curve, 2-3 year rates are the most attractive, with 10-year yields the most expensive.

Corporate bonds (Neutral)

- We remain cautiously overweight credit but have decreased our exposure to BBB-rated corporate debt.
- We are aware that corporate spreads are going to rely on market sentiment alone for the following 12 months as financial ratios signal increasing credit risk of bond issuers.
- While the profit and cash flow generation power of North American corporations is satisfactory, corporate leverage continues to increase on the back of substantial borrowing. Despite the fact that everybody needs yield in this world, we envision an environment where investors will remain selective in terms of credit quality which should cap returns to the upside for corporate bonds.
- This prompts us to be reluctant to invest in lower-rated (BBB) corporate bonds in this part of the credit cycle. By extension, we have decreased exposure to higher beta sectors to the benefit of corporate bonds issued by Financials.
- Similarly, in each industry, we opt for issuers with stronger credit profiles.

US equity (Positive)

- Valuations have run ahead of fundamentals due to highly accommodative US Federal Reserve monetary policy. Despite this we continue to expect corporate health to pick-up on the back of an improving consumer.
- All indicators including manufacturing, GDP, wages, unemployment and corporate spending indicate that corporate America remains on solid fundamental footing. Given these conditions, companies are able to continue to lever their income statements in order deliver higher margins, although it's difficult to see where continued upside catalysts will come from.
- We expect margins to remain high and temper current valuations as we move forward in the cycle. We rely on a lack of clear investment alternatives (given the low yield environment) as well as continued strength in retail spending to support our benchmark neutral position in the S&P 500.
- We continue to closely watch geopolitical risks including Russia-Ukraine, Ebola and ISIS, which for the time being have had little negative impact on equity returns.

Canadian equity (Negative)

- In the first half of the year, Canadian equities posted strong gains off of higher commodity prices, in particular oil.
- Analysts helped drive markets to new highs as upward revisions to corporate earnings estimates helped justify higher prices. In the second half of the year, howeve, concerns over increasing oil supplies and weakening global demand catalyzed an aggressive sell-off in the third quarter.
- Based on our indicators, TSX valuation remains vulnerable on continued weaker commodity prices, partially offset by strong financial fundamentals offering attractive valuations.

Real estate (REITs) (Neutral)

- Year-to-date REIT returns in the US and globally have been strong with the MSCI US REIT Index up almost 14% year-to-date and the Dow Jones Global Select Real Estate Securities Index up almost 10%. The strong performance may be attributed to positive fundamentals (e.g. lower vacancy rates, rent inflation) as well has lower 10-year US Treasury yields which have fallen approximately 65bps since the start of the year.
- With US GDP poised to grow for the remainder of 2014 and into 2015, the existence of strong fundamentals in the REIT sector evidenced by increasing occupancy levels and signs of rent inflation, REITs are in position to perform well over the remainder of the year. While REIT prices may be influenced by movements in 10-year treasuries or further concerns related to the direction the FED will take monetary policy, fundamentals remain compelling.

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

Investment philosophy

The Equitable Asset Management Group has held down the core investment function for Equitable Life Insurance Company since 1920. Our 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.