Equitable
Asset Management Group

Investment Playbook

Equitable Life Active Balanced Portfolios – Q3 2015

Content

Global economic outlook
Asset class outlook

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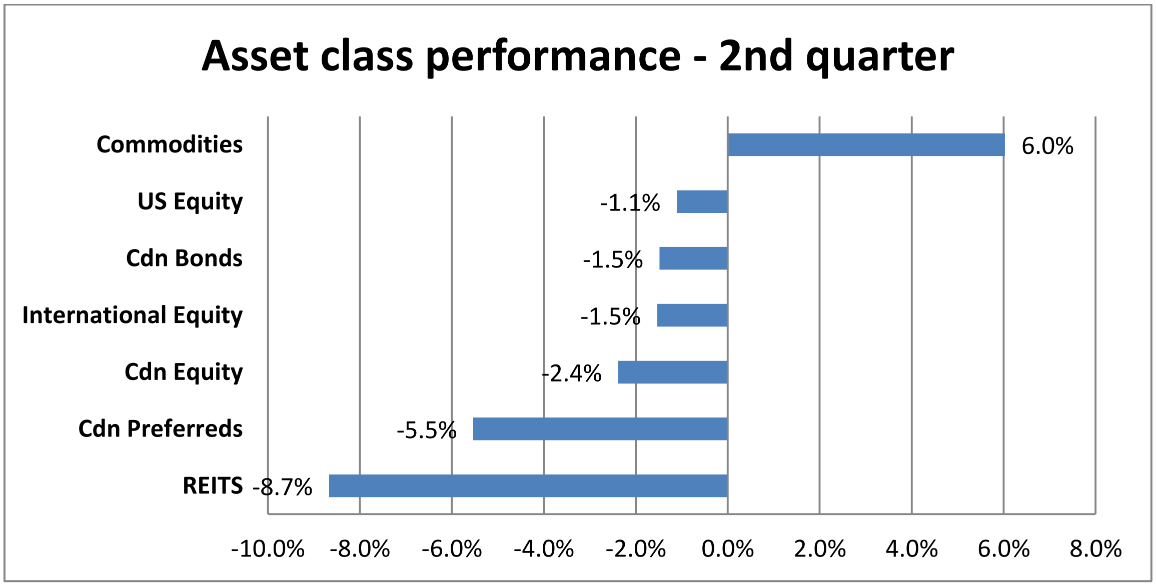

Summary

- International Economic growth is solid, the headwinds to Canadian growth have somewhat dissipated but remain a challenge to the Canadian economy.
- Our outlook is for the Canadian economy to grow just above 1%, less pessimistic than the less than 1% growth last quarter. Contributing to it is a marginally less negative outlook on the Canadian housing market with Toronto and Vancouver remaining resilient. We have also put behind us much of the energy related cuts to capital expenditures, although energy market instability continues to pose a risk to the broader Canadian economy.
- We prefer European and US equities over Canadian equities due to stronger economic performance but remain cautious in the US market due to high valuations.
- We remain neutral on Canadian government bonds with rates likely to remain around 1.5%, and bearish on US government bonds with rates likely to rise over the next twelve months.
- Our view on corporate bonds remains neutral for credit rated BBB and above.

Economic Outlook

Global (neutral)

- The first quarter of the year was another challenging one with harsh weather conditions and the West Coast port disrupting consumption and trade. Looking forward, conditions appear to have stabilized, not only on the domestic front but also with most of Europe returning to growth and deflationary pressures easing. While Greece is the focus of headlines as of this writing, we expect resolution by the end of the third quarter.

- In Japan there is fragile hope of stable growth as the trade balance and business investment have improved. At this point, the key is for consumer confidence and spending to increase allowing the recovery to spread through the economy. This leaves a number of hurdles to overcome, including the slowing economy in China negatively impacting exports.

- In order for China to manage their slowdown, the central bank is likely to continue taking measures to support the economy and there is room for them to continue down this path. Despite the actions they have taken to date, Chinese housing prices are likely to remain weak and domestic retail demand shows no signs of improving in the near-term.

- As global demand weakens and political uncertainty remains, oil prices are likely to remain volatile. Oil prices should be range bound as US and OPEC oil production continues to increase and oil wells remain set to come back online on any significant price increase.

United States (positive)

- With the mixed changes in the global backdrop, our forward US GDP growth expectations are unchanged, although the drivers are somewhat changed. The delayed impact of a stronger US dollar, as well as a brief slowdown in manufacturing, could result in deteriorating business investment, offset by stronger consumer spending on accelerating wages.

Canada (negative)

- In Canada we are putting much of the contraction in business investment behind us as oil industry cuts largely came through in the first quarter. On a forward four quarter basis, business investment will continue to contract by -0.1%, considerably less than the -0.5% we were forecasting previously. We have also moved the projection for housing and trade up marginally, and government spending down.

- The Toronto and Vancouver housing markets have shown strong resiliency, so while we expect slowing from the 0.3% contribution in Q1, we are less bearish than last quarter. We anticipate trade will continue to improve as we move forward as the delayed positive impact on trade from currency is realized. These improvements are partially offset by the weak government spending as Ontario cuts the budget.

Asset Class Outlook

Global equities (positive)

- Over the last several weeks, global equities have consolidated on increased concerns over Greece and the impact of future US rate hikes on equity markets. Thanks to this sell-off, stocks world-wide are now cheaper, offering more reasonable buy-in levels compared to several weeks ago. Despite this, the US remains expensive on a forward P/E basis compared to historical averages but offers greater value over the TSX. We believe Europe offers the best value on an improving economic backdrop.

US equities (positive)

- There is a significant lack of conviction amongst professional investors in terms of how US markets will perform over the coming 12 months. This is partially driven by uncertainty around interest rate hikes. Based on historical evidence, interest rate hikes from low levels have been supportive of equities, but typically within more robust economic environments. Never before have rates been held at such low levels for so long and, when compounded with mediocre growth and expensive markets, we are entering what appears to be unchartered territory. Despite this, we do believe that the lack of investment alternatives across the asset class spectrum continue to be supportive of equities.

- US fundamentals offer reasonable opportunities for investors, albeit at muted levels. Early indicators from the manufacturing sector are showing signs of strengthening. The closely tracked ISM PMI manufacturing index continues to show economic activity remains in expansive territory. And with wages firming, we remain hopeful that the US consumer will offset Q1 weather related weakness and drive economic growth in the right direction.

European equities (positive)

- In Europe, markets have responded positively as Greece and the ECB continue their debt negotiations. While resolution to this situation should be supportive of equities, we continue to monitor developing events closely as we believe the ECB is potentially “kicking the can down the road” with little long-term resolve to Greece’s debt struggles. Political events are difficult to forecast, and as such, our investment style is to focus on economic fundamentals to gain a sense of what the future holds. Based on this, we’re seeing further confirmation that European economies remain on track.

Canadian equities (negative)

- Canada remains a challenging market to invest in due to the intersection of lofty valuations and energy sector volatility. Investors appear to be playing momentum in the energy sector given P/E ratios remain at a staggering 35 times forward earnings. With oil production levels remaining elevated within the US and OPEC, we need to see a further acceleration in global demand to help stabilize energy markets. Until this occurs, Canada will more likely than not remain a volatile trade relative to the US and Europe.

Corporate bonds (neutral)

- We remain neutral on corporate bonds rated BBB and above with a short-term tactical underweight. Over the long-term, weakening fundamentals will be offset by the strong seasonal demand for corporate bonds. The recent deterioration in corporate fundamentals has much to do with a stronger US dollar as well as increasing corporate leverage. While corporate profitability remains vulnerable, low yields continue to force portfolio managers to reach for yield which is positively impacting corporate bond demand. Based on some deterioration in fundamentals, we continue to prefer investment grade bonds in the banking, utilities and infrastructure sectors.

- We envision two evolving scenarios for the market sentiment in the coming months. The first one relates to the propensity of corporate bonds to underperform around the first Fed rate hike on spikes in yield volatility. Despite the well-broadcasted rate hike expectation for September, we fear the market could go through moments of heightened volatility around the first rate hike which would hurt corporate bond performance. Historically, relative performance improves a few months after the first rate hike, until monetary and credit conditions become restrictive. On a twelve month horizon, an anticipated gradual rate hike cycle may give corporate bonds a longer window to slightly outperform broad corporate bond benchmarks.

- Under our second scenario, we envision sentiment worsens on the back of any further breakdown in the Greece debt situation and a delay in Fed interest rate hiking, as dealers will be less willing to take the opposite side of portfolio managers selling bonds. Should this happen, illiquid markets would negatively impact bond prices.

- While we see corporate credit metrics deteriorating into 2016, credit performance could remain fully reliant on positive sentiment alone. Balance sheet metrics continue to deteriorate as companies leverage up to boost corporate EPS growth resulting in lower free cash flow to debt ratios. We do not believe there is imminent risk of a deep slowdown in US or Canadian growth in 2015 that would result in a falling credit market. While the North American corporate sector is clearly in a more mature phase of a multi-year credit cycle, we think there will be one more opportunity to achieve positive excess returns from corporates once the market volatility surrounding the first Fed liftoff subsides. As well, the anticipated slow and gradual interest rate hikes could lengthen this window of opportunity during this cycle.

Fixed income (neutral)

- Fundamentally, and from a historic perspective, rates continue to remain at ultra-low levels. Inflation appears to have bottomed in Q1 and as we look forward, we believe inflation will begin to increase in the back half of 2015. This would be supportive of higher rates. Overall, global growth remains tepid and US growth is only starting to show signs of improvement. And while a rebound in Canada remains largely non-existent, the Fed hiking interest rates in 2015 could pull Canadian rates higher. Should growth in Canada rebound in the second half of the year (in-line with the Bank of Canada's expectations) we believe rates could be marginally higher by year end in the area of ~50bps. This scenario assumes stronger inflation and improving global growth.

EAMG interest rates outlook (neutral)

	10-year bonds
Canada (+12m)	1.50%
Current Rate	1.50%
US (+12m)	3.00%
Current Rate	2.20%

REITS (neutral)

- Thus far in 2015, interest rate hike fears have dominated REIT performance despite positive sector fundamentals. With US treasury yields expected to rise in 2015, short-term REIT performance should continue to face downside pressures. From a mid-longer term perspective, positive fundamentals, including increasing occupancy levels and signs of rent inflation, should begin to be priced in.

Equitable Active Balanced Portfolios Q3 positioning

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

About Active Balanced Portfolios Investment Playbook

- The Active Balanced Investment Playbook is a quarterly publication intended to communicate our high level asset class views
- This investment playbook can be used as a guide to better explain to clients how our portfolios are positioned
- Our portfolio line-up which includes Active Balanced Growth Portfolio Select, Active Balanced Portfolio Select and Active Balanced Income Portfolio Select are constructed based on the above asset class views

Equitable Life Active Balanced Portfolios purchase codes

		Investment class fund codes		Estate class fund codes	
Fund name	MERs*	DSC	No Load	DSC	No Load
Equitable Life Active Balanced Income Portfolio	2.35%	ELC638	ELC738	ELC838	ELC938
Equitable Life Active Balanced Portfolio	2.35%	ELC637	ELC737	ELC837	ELC937
Equitable Life Active Balanced Growth Portfolio	2.40%	ELC639	ELC739	ELC839	ELC939

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

Prepared for information purposes only and does not constitute investment, legal, accounting, tax or other professional advice.

Any statements contained herein that are not based on historical fact are forward-looking statements. Any forward-looking statements represent the portfolio manager's best judgment as of the present date as to what may occur in the future. However, forward-looking statements are subject to many risks, uncertainties and assumptions, and are based on the portfolio manager's present opinions and views. For this reason, the actual outcome of the events or results predicted may differ materially from what is expressed. Furthermore, the portfolio manager's views, opinions or assumptions may subsequently change based on previously unknown information, or for other reasons. Equitable Life of Canada® assumes no obligation to update any forward-looking information contained herein. The reader is cautioned to consider these and other factors carefully and not to place undue reliance on forward-looking statements. Investments may increase or decrease in value and are invested at the risk of the investor. Investment values change frequently and past performance does not guarantee future results. Professional advice should be sought before an investor embarks on any investment strategy.

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