Equitable
Asset Management Group

Investment Playbook

Equitable Life Active Balanced Portfolios – Q2 2016

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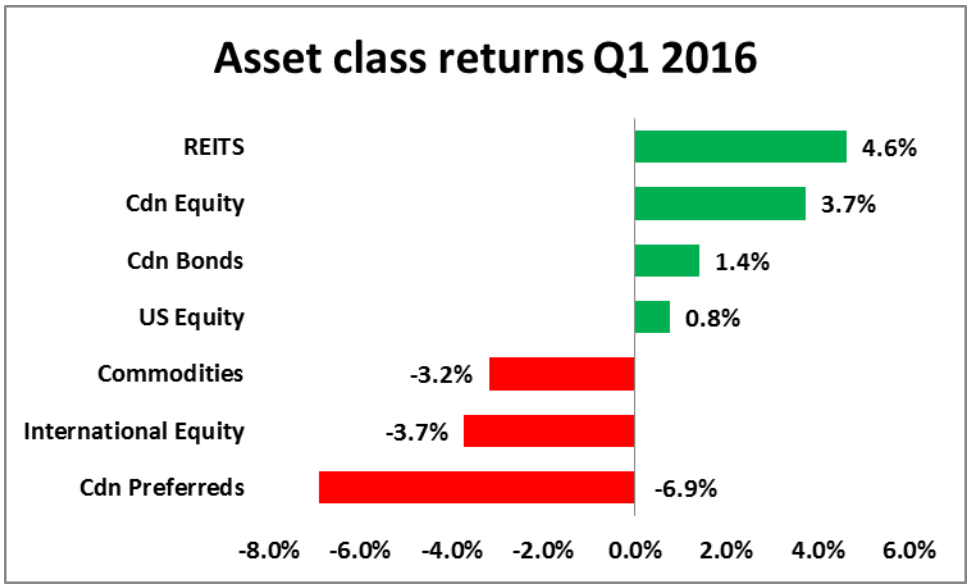
Paul English, MBA, CFA – Senior Vice President, Investments
Tara Proper, CFA – AVP Capital Markets
Derek Vinke, CFA – AVP Quantitative Investment and Portfolio Risk
Darrin Webley, CFA – Director, Private Placements
Sylvia Vyrostko, MBA - Director, Corporate Credit Portfolio Manager
Kevin Osborne, MBA, CFA – Fixed Income Portfolio Manager
David Irwin, MBA – Director, Equity Portfolio Manager
Ryan Laird, MBA – Corporate Credit, Senior Analyst



Source: Bloomberg, as of 03/30/2016

Economic outlook

- We are forecasting US GDP of 1.8% over the next 12 months, relatively unchanged versus our last strategy. Driving the low growth environment is US personal consumption which is showing some signs of slowing. Offsetting this weakness is a softening US dollar which will likely lower the drag from trade going forward.
- Inflation in the US has been edging up, with core readings reaching 2.3% in February driven by housing, medical care and services.
- Once the base effects of energy prices disappear, declining unemployment and solid wage inflation is likely to help push inflation upward over the coming year in the US.
- Our growth expectations for Canada remain lower than the US at 1.5% GDP growth over the next four quarters.
- Recent strength in the Canadian dollar is likely to result in slightly lower contribution from trade in the coming quarters. This is offset by stronger than expected personal consumption, prompting us to revise up our forward four quarter outlook.
- Canadian inflation has been running just under 2% due to lower service inflation running at 1.6%. Given the weaker employment market in Canada, we expect that wage inflation will soften, offsetting import inflation pressures.
- In both Canada and the US, our outlook remains below consensus views with risks weighing to the downside.

Asset class outlooks

Fixed income (Neutral to Negative)

- Rates to remain near all-time lows and will be challenged to move materially higher from current levels.
- Risk environment has improved quarter-over-quarter; however risks do remain elevated as the global growth outlook remains fragile. The risk of a Brexit is an immediate threat as recent polls show an evenly split voter base.
- North American deflationary risks are abating; commodities show signs of stability as global supply/demand dynamic potentially enters early stages of a rebalance.
- Global monetary policy to remain accommodative; ECB and BoJ continue to push aggressive monetary policy, Fed has begun a cautious hiking cycle. BoC to consider further monetary stimulus if growth disappoints; negative rates a possibility but not baseline. We see a divergent monetary policy relative to the US Fed to continue.
- Flows into Canadian sovereign debt market have slowed; supply to increase over medium term.
- Globally, developed world deleveraging and aging demographics continue to put pressure on yields.
- Yields will be challenged to move materially higher from current levels but should move higher in sympathy with US yields.

Corporate bonds (Negative)

- Our credit recommendation remains negative as weakening fundamentals and poor credit metrics in North American corporations are expected to persist for the remainder of 2016.
- In addition to deterioration in corporate profitability, and tightening lending standards by banks, the Federal Reserve is expected to tighten monetary policy, making the environment for corporate credit even more negative than previous quarters.
- Corporate bond prices are expected to continue to be volatile with poor sentiment and further rating downgrades.
- Current prices have not priced in the future probability of defaults in Canada and the US, which we expect to begin in the energy sector,making us believe that there is still risk in corporate spreads.
- Unchanged from the last review, we have less preference for the lower rated investment grade bonds (BBB-rated) and cyclical sectors and prefer issuers with higher credit quality in each sector. We also prefer to maintain flexibility in finding tactical opportunities to reduce risk on rallies.

Equities (Negative)

- Our view of equity markets remains unchanged with an underweight recommendation given expensive valuations and weak corporate fundamentals.
- Aggregate financial results for companies listed on the S&P 500 have been declining for four consecutive quarters on a year-over-year basis as the overall demand environment remains challenged.
- In addition to a weak fundamental backdrop, profits remain challenged given the significant slack in capacity utilization as well as potential signs of increasing wages pressuring profits.
- While fundamentals remain challenged, we're seeing several bright spots including positive manufacturing readings both at regional and national levels.
- Our views on Canadian equities remains weak given a lack of resolve in oil supply-demand dynamics. Contributing to the negative view are valuations which remain near record highs.
- EAFE represents the most attractive developed market given a slowly improving economic backdrop in Europe. While Europe is not without risks, valuations remain at historical lows leading us to believe that too much risk has been priced into that market.
- Japanese equities remain challenged due to continued deflationary headwinds, as well as a slumping global demand for Japan's exports, but valuations are compelling.
- Based on these views, our overall recommendation calls for an underweight position in Canada and the US with a neutral position in the EAFE.

REITs (Negative)

- While our favourable view of REITs fundamentals remains unchanged from our previous strategy, the historical relationship between 10-year treasury yields and REIT prices has broken down in 2016, driven by a significant sell-off in equities.
- We recognize interest rate hikes by the US Fed may catalyze some short-term selling, but our base case view remains that REITs will be minimally impacted given the fundamentals for the asset class remain intact.
- Despite our belief that fundamentals remain supportive of REITs, we have gone underweight based on technical signals which currently indicate downside risks.
- Based on current Global REIT prices, we remain underweight until we receive confirmation of a break in the range bound markets we are currently trading within.

Current positioning – As of 03/30/2016

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