Equitable
Asset Management Group

Investment Playbook

Active Balanced portfolios – Q2 2017

Content

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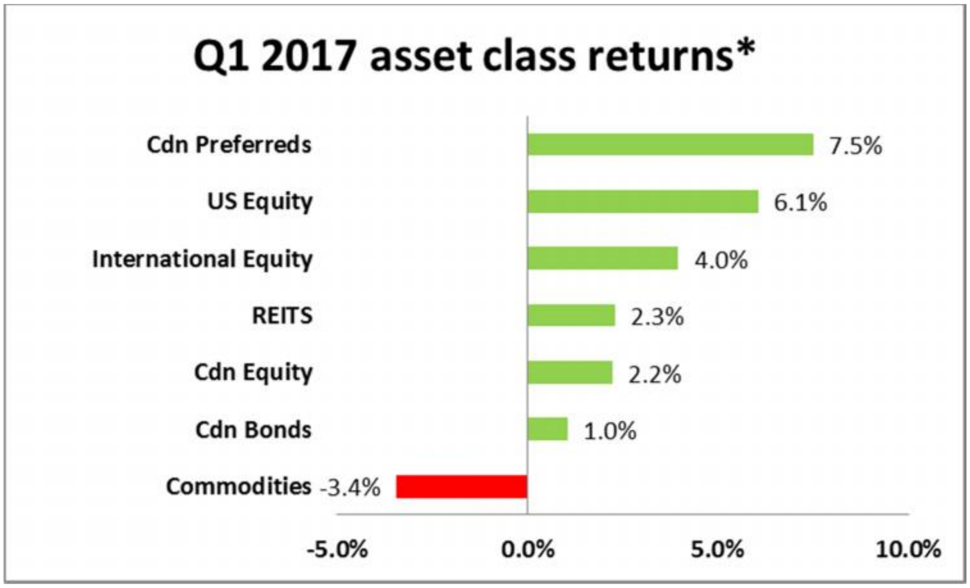

Source: Bloomberg, as of 03/31/2017
***Commodities = Thomson Reuters/Core Commodity Index, Cdn Preferreds = S&P/TSX Preferred TR Index, International Equity = MSCI EAFE Index, US Equity = S&P 500 Total Return Index, Cdn Bonds = Bloomberg Canada Sovereign and Corporate Composite Bond Index, REITs = FTSE NAREIT Developed Total Return Index**

Economic outlook

Canada (Neutral)

- Our overall expectation of growth in the coming 12 months is 2.0% with downside risks outweighing upside risks.
- While downside risks remain significant, Canada's economy has surprised to the upside so far in 2017. From a contribution to total GDP growth perspective, we expect that the consumer and government sectors will support economic growth in the coming months.
- The Canadian consumer is expected to be the biggest contributor, although the downside risks remain significant. In particular, the debt-to-disposable income ratio reached a record high of 167.3% in the fourth quarter of 2016. And while net worth increased 7.4% year-over-year to a record high of $10.3 trillion, much of this was driven by the real estate market, which we expect will cool as we approach the end of 2017.
- The Bank of Canada is likely to keep interest rates at current levels. They continue to focus on inflation. While headline inflation is like to increase as oil prices have rebounded significantly since last year, the Bank will focus on core inflation which will remain low for the coming year. The Central Bank remains focused on the risks posed by the housing market as well as high consumer debt levels and will be cautious about hiking rates too quickly.

US (Neutral)

- The US economy will grow in the area of 2.25% in 2017, once again driven by the consumer. Fiscal spending will disappoint current market expectations and current business and consumer sentiment is susceptible to a pullback as political gridlock weighs.

- Trump's first three months in office have demonstrated that he is keen on following through on his campaign promises. However, the recent battle over the repeal of Obamacare highlights the divide within Trump's own Republican Party and does not bode well for timely agreement on tax reform and infrastructure spending. Couple this with polarization across the aisle and bipartisan cooperation appears unlikely.
- Any progress on fiscal stimulus will be a long drawn out process and the resulting economic boost will be a 2018 or later phenomenon.

Asset Class Outlook
Government bonds (Neutral)

- Over the next year, we expect 10-year rates to move marginally higher in Canada but less than US rates. Shorter term rates in Canada should remain low on domestic central bank policy with the 10-year rate dragged higher by US rates.
- Policy reform from the Trump administration has been the biggest single influence on North American bonds, yet yields spent the end of the first quarter in a fairly tight trading range as the Trump rally took a breather.
- US fiscal policy remains a potential catalyst for higher yields, although we believe the move higher will be muted given the challenges that remain in moving these policies forward.
- North American deflationary risks are largely abated; commodities have rebounded but the outlook for oil remains unclear. As well, there is less upside risk to inflation on US policy reform over the quarter.
- We expect the risk environment to remain stable; trade protectionism remains the biggest risk however, followed by the Italian banking sector, French elections and the Brexit.
- Divergent Canadian/US monetary policy remains topical. The US Federal Reserve continues along a pathway of gradual tightening with risk of a faster pace, while the Bank of Canada remains on hold for a prolonged period. Sovereign yields in both markets continue to look attractive from a global perspective.
- Flows into Canadian sovereign debt markets continue to show strength.
- While global monetary policy is generally less accommodative, the European Central Bank (ECB) continues to stimulate at a slower pace, the Bank of Japan is set to continue its aggressive monetary policy, and the Bank of England faces the dilemma of higher inflation coupled with lower growth.
- Longer term trends in the developed world toward deleveraging and unfavorable demographics will continue to keep interest rates low by historical standards. The resulting Canadian fixed income environment will see yields pulled higher by US treasury yields as a result of stronger fundamentals, rising inflation and less accommodative monetary policy.

Corporate bonds (Positive)

- We expect to see improved GDP growth, firmer commodity prices and higher bond yields through 2017 which should provide support for corporate bonds to continue their positive performance.
- Corporate fundamentals remain stable although central banks are becoming less of a tailwind. In the coming 12 months, it will be important to move into segments of the market that can still perform well in this environment.
- As long as economic growth and central bank tightening remains gradual, the environment will likely be supportive of corporate bonds. However, interest rates moving higher too quickly could negatively impact the economy leading to the next credit cycle downturn.
- From a more technical point of view, demand for corporate bonds remains strong and issuance is expected to be lower than 2016 and, therefore, supportive of prices. Canada continues to benefit from a liquid market, large issuers with strong competitive positions in their markets, and a breadth of investable sectors and issuers across the credit spectrum.
- As well, on a year-to-date basis, ratings agencies have taken on a more positive view of the market with ratings migrating towards a more positive direction.
- Based on the solid economic backdrop and a positive technical view of the bond market, we remain positive on corporate bonds over the next 12 months.

Equities (Positive)

- While markets are expensive compared to historical levels, relative to bonds, equities are the cheaper asset class and, based on this, may continue to attract positive investment flows.
- Markets remain expensive on a variety of measures, in particular price-to-earnings ratios which are trading at multi-year highs. While not generally regarded as a good market timing indicator, P/E ratios do give us an idea of potential return opportunity going forward. That is the higher they go, the more muted forward returns are expected to be.
- Uncertainty remains high across markets and appears to be increasing, in particular with increasing political risks. In the US, the Trump reflation trade hangs in the balance after a 10% post-election rally with investors taking a wait and see approach to developments in Washington.
- Canada stands to benefit from US economic strength, but carries a different risk profile given the high energy component, which is expected to contribute 50% of earnings growth on the S&P/TSX Composite Index.
- Given continued supply-demand imbalances within the oil market, a more tactical approach to Canada will be employed until we see greater clarification that US shale and OPEC production can find equilibrium.
- International equities remain the most attractive region. Europe appears to be finally seeing a pick-up in profitability relative to the US and therefore we see greater opportunity in international equities compared to the US and Canada. While the European political landscape offers an elevated risk backdrop, investors have been well compensated for taking on risk in the face of political uncertainty which may continue in the coming 12 months.

- We include Japan within our favorable view of international equities given an improved economic backdrop as well as strong support from the Bank of Japan.
- Overall, we have a positive view on equities given the decent economic backdrop coupled with low interest rates which make equities appear cheaper than P/E ratios indicate.

REITs (Positive)

- Our positioning on REITs remains in neutral to positive territory as articulated in our previous annual strategy.
- On a historical basis, REITs have been a solid performer providing an average annual return of 10.8% between 2002 and 2016 with only two years of negative returns (2007 and 2008) and outperforming the S&P 500 in 11 of those 15 years.
- Further to that, they provide a yield that is 1.5% above 10-year US Treasuries and 2.0% above the S&P 500 dividend yield. REITs are also trading at a discount to their calculated net-asset-values and have done so since the end of October and, therefore, offer potentially good value.
- Based on a decent economic backdrop, good historical performance relative to the S&P 500 as well as solid distributions, we remain positive on returns within REITs over the coming 12 months.

Portfolio positioning

Asset class	3/31/2017	12/31/2016
Cash	**Neutral**	**Neutral**
Government bonds	**Neutral**	**Neutral**
Corporate bonds	**Neutral**	**Neutral**
Equity	**Neutral**	**Neutral**
Canada	**Neutral**	**Neutral**
US	**Neutral**	**Neutral**
International	**Neutral**	**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 maximizes 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

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