Equitable
Asset Management Group

Investment Playbook

Active Balanced portfolios – Q3 2017

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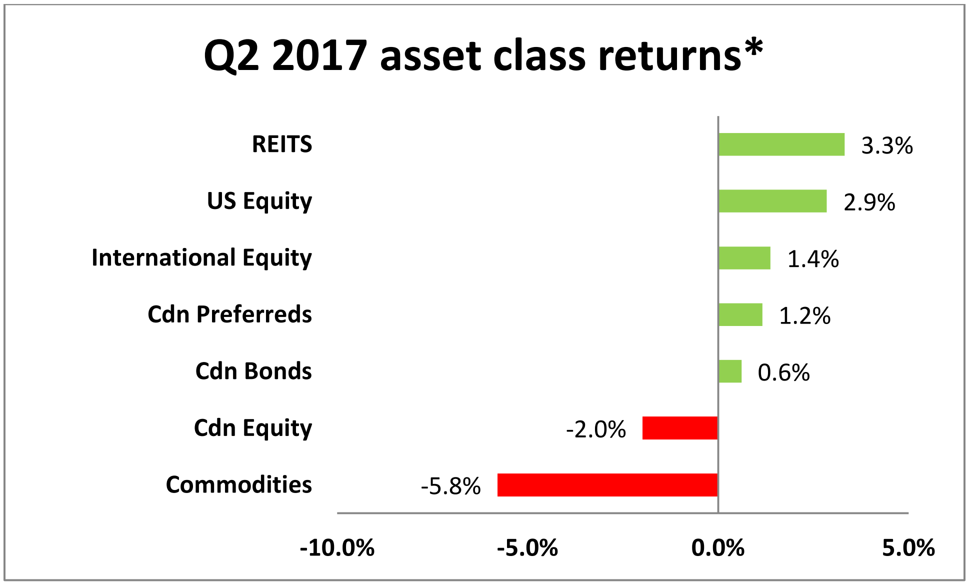

Source: Bloomberg, as of 06/30/2017
*Commodities = Thomson Reuters/Core Commodity Index, Cdn Preferred shares = S&P/TSX Preferred TR Index, International Equity = MSCI EAFE Index, US Equity = S&P 500 Total Return Index, Cdn Bonds = Bloomberg Canada Sovereign and Corporate Composite Bond Index, REITs = FTSE NAREIT Developed Total Return Index

Economic Outlook

- Very little has changed to our US political outlook since the last quarterly strategy. Political gridlock appears to have returned to Washington and, as a result, very little progress has been made with regards to fiscal policy or trade negotiations.
- Despite declining oil prices and less monetary stimulus, emerging markets remain stable as global trade has been on an improving trend. China's economy has improved slightly since the beginning of 2017 and large shocks have become less likely in terms of trade policies with the US and the strength of the global economy.
- Canadian GDP jumped 3.7% in Q1, with significant support coming from business investment, which saw a 10.3% annualized quarterly increase. This was the largest increase in almost 5 years and followed 2 years of persistent declines. The solid run of Canadian data continues at a pace that has likely kept Q2 on track for about 2.5% growth. The Bank of Canada now appears to be on a more hawkish path, and increasing the overnight rate in July. Going forward, it is expected that contributions from the consumer and business investment will increase, albeit at a moderated pace, and on a four quarter forward basis Canadian GDP will grow by 2.2%.
- The US economy will grow at about the same pace as Canada over the coming four quarters. We continue to look for signs of positive sentiment to materialize in business investment and consumer spending, although political gridlock has become an impediment to business investment.
- In Europe, growth will remain healthy over the coming 12 months driven by strong business investment as a result of internal demand. The ECB will maintain accommodation for longer than the market expects which will keep government contributions largely on the sidelines until greater stimulus is required at the state level. A more stable political backdrop and improving labour market will accelerate

consumer activity. Inflation will remain weak given ample slack in the labour market as well as continued weakness in commodities.
- Japanese GDP is likely to grow at a moderate 1% pace, driven primarily by a solid labour market, continued business investment and trade, with government spending picking up over time.

Asset Class Outlook
Government bonds (Neutral)
- Yields remain poised to move higher (marginally), buoyed by central bank policy.
- The reflation trade has largely been priced out as market expectations of higher inflation and growth from policy reform in the US have both softened and been pushed further out the forecast horizon.
- North American deflationary risks re-emerge with downside risks from energy and fiscal stimulus.
- The risk environment remains benign; trade protectionism remains the biggest risk and North Korea is a wild card.
- Both the Bank of Canada (BoC) and the US Federal Reserve (Fed) remain poised to normalize policy. The Fed continues along path of gradual tightening with a risk of faster rate hikes than expected. The BoC is poised to remove the 'insurance rate cuts' from the 2015 oil price collapse. Sovereign yields in both markets continue to look attractive from a global perspective.
- Global monetary policy is less accommodative; the ECB continues to stimulate at a slower pace, the Bank of Japan should continue to push aggressive monetary policy, while the Bank of England moves towards tightening bias.
- From a longer term perspective, developed world deleveraging and the demographic backdrop will continue to keep a lid on interest rates.
- The resulting Canadian fixed income environment will see yields pulled higher by US government bonds as a result of the stronger corporate and economic fundamentals, and less accommodative monetary policy.

Corporate bonds (Positive)
- Our credit recommendation is overweight although moving closer to neutral.
- Improved global growth, firmer commodity prices and higher bond yields will provide support for spreads to continue to compress, albeit at a slower pace.
- Over the short-term we see moderate new issuance, and the need to turn to corporates to earn more attractive all-in yields as central banks move towards tightening policies.
- While corporate bond coupon income remains reasonable, there continues to be areas of risk in the economy, which will require close monitoring. Credit event risk is a key consideration that can abruptly change the positive environment.
- As central banks reduce stimulus, the risk grows and thus we recommend slowly moving towards higher quality investments.

Equities (Positive)

- After hitting highs in June, the S&P 500 remains the most expensive equity market. A lack of traction on either health care or tax reform represents potential downside risk.
- Corporate fundamentals remain positive with our supply/demand indicators all suggesting mid-single digit revenue growth. Earnings per share (EPS) should continue at double digit growth, on a low operating cost environment and historically elevated share buybacks.
- S&P/TSX Composite trades ‘2 multiple points lower than the S&P 500, representing a significant discount not seen since the 2007 financial credit crisis.
- Canadian banking sector fears focused on a overleveraged consumer and a vulnerable housing remain overblown. Labour market strength, low interest rate levels and importantly a potential soft landing in housing could repair the negative sentiment on the banks.
- We believe a recovery is currently underway in the oil industry and will help reverse the significant underperformance the TSX endured in the first half of 2017.
- NAFTA negotiations will most likely offer volatility at some point during the negotiations, but our view is there will be no significant disruption to Canadian growth.
- EAFE (International Equities) remains our top-rated market driven by strong economic and corporate fundamental performance within core EU. Strengthening consumer and business confidence and relatively attractive valuations suggest the EAFE remains an attractive market from a risk/return perspective.

REITs (Neutral)

- While it is not our expectation REITs will outperform the S&P in 2017, we expect a reasonable year with a total return somewhat lower than what was observed last year.
- Vacancy rates and rent growth remain healthy. New construction activity continues to remain below average levels witnessed during 1993-2008 and increases in leased space have exceeded over last year.
- While fundamentals remain reasonable for most sectors, Retail REITs are struggling amidst retailer concerns, with e-commerce a commonly cited reason for some of the decline.
- The Fed potentially unwinding their balance sheet starting in September and changing probabilities of an interest rate hike in December could impact views on sector performance. Generally speaking, it is worth reiterating that REITs can withstand rising rates when coupled with macroeconomic growth as it tends to result in occupancy increases and rent growth.

Portfolio positioning

Asset class	6/30/2017	3/31/2017
Cash	**Negative**	**Neutral**
Government bonds	**Neutral**	**Neutral**
Corporate bonds	**Positive**	**Neutral**
Equity	**Positive**	**Neutral**
Canada	**Neutral**	**Neutral**
US	**Neutral**	**Neutral**
International	**Positive**	**Neutral**
Real estate (REITs)	**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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