Equitable
Asset Management Group

Investment Playbook

Active Balanced Portfolios – Q3 2019

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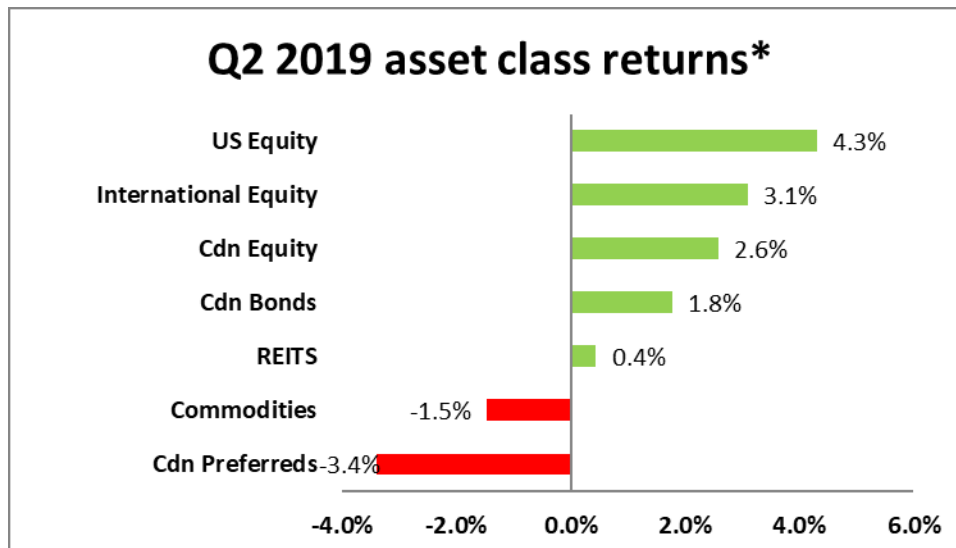

Source: Bloomberg, as of 6/28/2019
*Commodities = Thomson Reuters/Core Commodity Index, Cdn Preferred shares = S&P/TSX Preferred TR Index, International Equity = MSCI EAFE Index, US Equity = S&P 500 Total Return Index, Cdn Bonds = BMO ZAG

Executive Summary

Economics:

- The outlook for growth is relatively unchanged since the last strategy, with Canadian GDP expected to grow by 1.5%, and US GDP by 1.9% over the coming four quarters.
- Personal consumption remains the biggest contributor but remains lower than previous years primarily due to expectations of slowing employment growth.
- Business investment is expected to improve from previous years due to higher oil prices, but pipeline capacity and a stronger US dollar may hinder growth.
- Downside risks continue to put pressure on economic growth expectations, including but not limited to weak global growth expectations, trade, China, Brexit, financial market volatility, increasing input costs, reduced profit margins/revenue expectations, reduced CAPEX plans, and declining business/consumer confidence. Although. this is somewhat tempered by increased dovishness of central banks.
- In Canada, core inflation measures have moved above the Bank of Canada's targets in recent months. This could be transitory, and inflation could move down to the target rate of 2%, but there is little sign that inflation will be below target over the next 12 months. We also expect core consumer expenditures in the US will increase roughly 2% as rising wages, higher input costs and a potentially weaker US dollar will begin to put pressure on prices.
- Our expectations are for no rate cuts by the Bank of Canada and that the Federal Reserve will cut rates by 50 bps in 2019 with the potential for an additional 25 bps

rate cut in the first half of 2020. If the Fed is more dovish than this, the Bank of Canada will likely need to cut rates as well.

- Slowing growth in China remains one of the biggest risks. The stimulus measures taken by the PBoC and Chinese government have allowed the economy to remain stable, however the headwinds, most notably trade, are significant. As domestic demand is subdued, manufacturing data remains sluggish and credit growth is very modest. We expect to continue to see central bank easing to support growth. While risks remain to the downside, we remain optimistic that the centralized government will continue to add stimulus and support a managed slowing of the economy.

Asset Class Outlook

Fixed Income (Neutral)

- In the short-term, we expect rates to consolidate within the current range as markets determine the persistence of the global growth weakness and the extent to which Central Banks will support markets.
- The level of yields and the shape of the curve in the long term (1yr) is likely contingent on Fed policy and inflation expectations (if they materialize). We expect short rates to fall faster than long-term rates in the yield curve one year out as weaker economic data and accumulating global risks in Q1 and Q2 of 2020 lead markets to price in further rate cuts.
- The path of 10-year (and longer) treasuries ultimately will be driven by growth and inflation expectations, which should drift upwards with a stimulative monetary policy. However structural factors such as demographics and productivity bring into question whether inflation will materialize at all.
- We expect some weakness in the 10-year part of the yield curve; however, we believe that the long-end will be contained by liability driven demands and weaker supply from the banks.
- A bar-belled position in 2-year bonds and 30-year bonds may outperform in both short-term and long-term scenarios.

Corporate bonds (Neutral)

- We see two contradictory market forces at work comprised of deteriorating long-term corporate credit fundamentals and an increasingly accommodative central bank policy environment.
- Accommodative central bank policy seems to be driving credit markets in the short-term and fundamental corporate vulnerabilities which could be exacerbated by a slowdown in global growth and/or a deepening of trade tensions and geopolitical threats could drive the credit markets lower in the long-term.
- In our opinion, this is a fragile situation for the credit markets in general and credit spread movements are at the whims of monetary policy and/or external global

events like geopolitical risks or other liquidity events. We believe that in such a backdrop, a credit rally is neither sustainable nor healthy.

- In the event of external shocks, even a gradual policy easing may work with a lag to counter a sudden and significant widening of credit risk premiums. A weakening in corporate credit quality would affect investors through both direct credit losses and increased market stress from potential downgrades, particularly with BBB-rated issuers.
- Based on these factors, for the long-term, we have changed our view from neutral to a negative trending bias. We need to see evidence of balance sheet repair, either through stronger EBTIDA growth or debt reduction, to get more constructive on credit in the long-term.
- The market consensus among equity analysts is that earnings growth is expected to normalize to pre-US tax reforms of mid-to-high single digit growth. In addition, we have not seen companies show any evidence of deleveraging. These factors have led us to maintain a cautious credit stand and focus on higher quality credits in the longer term.
- In the short-term, central bank policies, spread valuation, Canadian dollar issuance and investor sentiment/momentum are factors that seem to be driving the credit markets higher, and we see these technical factors as marginally favorable, giving us a neutral view on credits in the short-term.
- Our neutral short-term credit view would be expressed by being in higher quality credits, short-to-mid duration BBB credits and opportunistically trading to take advantage of the market conditions to express our risk posture.

Equities (Bearish)

- Based on our weight of evidence framework, a strategic underweight is recommended until we see more certainty surrounding US trade policy and US monetary policy.
- The macro and fundamental view for US equities has weakened in the past 6 months, reinforced by Wall Street's negative earnings revisions and a more conservative view from corporate executives.
- Valuations remain above long-term levels and appear to have priced in very little in terms of risk, which can reduce the margin of safety in the market.
- The offset is the low-rate environment could help support valuations and liquidity as well. While this has historically been positive for equities, there are too many negative catalysts that remain unresolved which we believe puts risk to the downside for the S&P 500.
- The S&P/TSX Composite Index, like the US market, will likely remain challenged but by unique Canadian risks including consumer indebtedness, greater exposure to a slowing global economy and a lack of pipeline capacity.

Asset class	6/30/2019	3/30/2019
Cash	**Neutral**	**Neutral**
Government bonds	**Neutral**	**Neutral**
Corporate bonds	**Neutral**	**Neutral**
Equity	**Neutral**	**Neutral**
Canada	**Neutral**	**Overweight**
US	**Neutral**	**Overweight**
International	**Underweight**	**Underweight**

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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