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“Unknown Territory”

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the Empire Life Investments Conference Call.

Today's discussion may include forward-looking information that are based on the opinion and views of Empire Life Investments, or the individual presenting. These views are subject to change and are not investment advice.

I would now like to turn the meeting over to Mr. Paul Holba. Please go ahead, Mr. Holba.

Paul Holba, Vice President, Retail Distribution

Thanks, Laurie. Good day, everyone. I am your host for today. I'm Paul Holba, Vice President of Retail Distribution at Empire Life. I'd like to welcome you all to our conference call today, which we've entitled Unknown Territory.

Before we begin, on behalf of the entire Empire Life Sales team, we really just want to say thank you for your business. We really appreciate the trust and confidence that you continue to show by placing your client's money with us. I also want to thank our investment team for their hard work. As of the middle of the year, June 30, we have seven funds that received a five-star or four-star Morningstar rating*, and our Asset Allocation Fund, which is the four-star overall Morningstar rating, we just celebrated 25 years of managing that fund. Later this year with Elite Equity, which is also a four-star rated fund, we'll be celebrating 50 years, and we look to have a nice celebration for that when the time comes. These funds are proven performers that have weathered through many different political and economic crises. You can ask about our flyers that we're celebrating the two funds' anniversary, as I mentioned.

Today's topic is Unknown Territory. We're at 120 months. The current business expansion is the longest in history and shows conflicting indicators for the future. Unemployment is at a decades low and equity prices are at record highs, while the collapse in global bond yields has been quite swift. This aging market is looking increasingly fragile as it takes just one tweet from Mr. Trump to swing the capital markets in a full scale risk-off mode. Politics are having an oversized effect on markets. This should be viewed based on fundamentals. The visibility is low and uncertainty is high.

How do investors navigate through this unknown territory? To answer that question, I've got a panel of portfolio managers in front of me today. First up to my right, we've got Ian Hardacre. Ian's Senior Vice President and Chief Investment Officer. He's joined by Doug Cooper, who's across the table from me. Doug's the Senior Portfolio Manager, Canadian Equities. Albert Ngo, who's also seated across the table, is Portfolio Manager, Fixed Income.

Today, they'll be discussing how markets have performed so far in 2019 and their plans to achieve sustainable future returns by focusing on quality, value, and managing risk. Then we'll open up the lines to take your questions. So, please, get your questions ready. Some of you have already submitted questions to me earlier, so we'll ask some of those later on.

Before we do talk of the economic and market environment. Ian, you have some news to share with us.

Ian Hardacre, Senior Vice President and Chief Investment Officer

Yes. Thanks, Paul. I'd like to make a few comments about the team. I'm pleased to announce that effective in the beginning of July, Jennifer Law took over as Lead Manager of the Canadian Equity Fund, and Doug Cooper took over as Lead Manager of the Dividend

Growth Fund. Both have done a great job over the past few years since they joined the Company, so congrats to both Jennifer and Doug. I'm also optimistic that we will announce a new Global Lead Manager in the very near term, so stay tuned on that.

Paul Holba, Vice President, Retail Distribution

Great. Thanks, Ian. I'm going to go right back to you. The U.S. equity markets have experienced–we'll call them several sharp swings since the end of last year. Can you bring us up to speed on exactly how U.S. equities have fared so far in 2019?

Ian Hardacre, Senior Vice President and Chief Investment Officer

Sure. Thanks, Paul, and good morning to everybody. After a volatile December, when U.S. equities narrowly avoided what would technically be considered a bear market, the S&P 500 had a powerful rally in early 2019, mainly because the Federal Reserve abandoned its tightening plan due to potential trade tension and its impact on economic activity going forward.

Broadly speaking, results in the U.S. have been quite good. By April, the U.S. economy had its 103rd straight month of job growth and jobless rates fell to 3.6 percent, which was a 50-year low. GDP increased at a better than expected 3.1 percent during the first quarter of the year. Corporate profits were at a record, and there are also signs of meaningful progress in the U.S./China trade talks. The S&P 500 Index hit an all-time high, going up by 18 percent at the end of April.

However, in early May, the U.S./China trade negotiations unexpectedly fell apart. President Trump increased tariffs on China. The market had priced in a positive resolution to the trade dispute, so the surprise breakdown led to sharp reversals in sentiment. Making matters worse, Trump opened up some additional trade war fronts, including with Mexico, where he threatened tariffs as a tool to help control migrants. May was a weak month and U.S. equities declined 6 percent from their all-time high.

Getting into June, stocks rose despite mounting fears of an economic slowdown, partially thanks to a shift in perception that the Fed would start to cut rates. The dovish signals from the central bank encouraged investors to pile into risky assets. The S&P 500 climbed back to its April highs by the end of June and continues to hit new highs as we move through July, as trade tensions between the U.S. and China eased during the G20 meeting. The S&P 500 Total Return Index capped its best first half since 1997, rising 18.5 percent, which was approximately 13.7 percent in Canadian dollar terms.

Sector-wide, areas of the market tied to technology have outperformed. Information technology sector was the best performing, with a total return of more than 27 percent. The relatively new communication service sector, which includes Facebook, Twitter, Google, also outperformed. Other outperforming sectors include consumer discretionary, industrials, and real estate. Now, on the other hand, after being the strongest performer last year, healthcare was the worst performing sector. The fear of the government intervention weighed on healthcare share prices, which only rose about 8 percent. The volatility in prices of commodities, such as oil and copper, also weighed on materials and energy stocks, both of those also underperforming with healthcare in the bond market.

Paul Holba, Vice President, Retail Distribution

Thanks, Ian. Albert, I mentioned earlier the collapse of the government bond yields since the end of Q3 last year has been stark, swift, and global. Can you give us your perspective on just what happened?

Albert Ngo, Portfolio Manager, Fixed Income

Sure, Paul. Things have really moved quickly in bond markets. In the span of six months, the Fed has gone from hiking mode to pause mode, and now quickly to easing mode. So, just for some context, if we look back in 2018, under the backdrop of strong growth, the Fed and Bank of Canada raised rates multiple times. The U.S. 10-year Treasury yield increased to 3.2 percent in November, and the Government of Canada 10-year yield increased to 2.6 percent. Both were the highest in six years. As recent as October of last year, expectations were that the Fed hiking cycle would continue to 2019, and the market had actually priced in three hikes in 2019. In January of this year, in light of slowing global growth and muted inflation, the Fed began to shift its policy stance from hiking mode to pause mode, citing the need to be more patient, and that was a very quick reversal. But as the year progressed, downside risk surrounding trade tensions and global growth increased, and in June, the Fed announced they would be open to additional rate cuts to sustain growth. Now, the market is expecting the Fed to cut by about 75 basis points, while the Bank of Canada is expected to cut to keep the overnight rates flat. In Europe, the market is pricing in 20 basis points of cuts by the ECB.

As a result of this policy shift by central banks all over the world, the rally in government bonds has been broad-based. The U.S. 10-year yield has declined 120 basis points to below 2 percent, while the Government of Canada's 10-year yields has declined by 100 basis points to 1.6 percent. Both are at three-year lows. In Germany and France, the 10-year bond yields have fallen into negative territory and are at record lows.

Remember, when yields fall, the price of the bond increases, so government bonds—and remember that also government bonds are very sensitive to interest rates. As a result, government bond indices in Canada and the U.S. have generated strong returns so far this year of about 5 percent.

In the corporate bond market, with both a declining interest rate environment and a risk-on sentiment year-to-date, this has been particularly supportive of corporate bond markets. Year-to-date, Canadian investment grade corporate bonds have returned 6 percent, U.S. investment grade bonds have returned 11 percent, and high-yield bonds have returned 10 percent.

Paul Holba, Vice President, Retail Distribution

Impressive returns from the boring bond market, huh?

Albert Ngo, Portfolio Manager, Fixed Income

Absolutely.

Paul Holba, Vice President, Retail Distribution

Yes. Doug, the Canadian equity market delivered strong performance for the first half of the year, outpacing both the U.S. and international. What's your take on what transpired in Canadian equities?

Doug Cooper, Senior Portfolio Manager, Canadian Equities

Sure, Paul. While the S&P/TSX Total Return Index is up roughly 17 percent year-to-date, we've really only recouped the losses that we experienced towards the end of last year. The year-to-date rally for the S&P/TSX can primarily be attributed to the de-escalation of the U.S./China trade war, coupled with Canadian equity valuations really reaching washed out levels in December of last year. Equity market strength year-to-date was broad-based across all sectors. Canada's three big sectors, financials, energy, and materials, posted strong absolute returns. However, all three of these sectors underperformed the S&P/TSX. Much stronger year-to-date returns were delivered by sectors perceived to be less cyclical or macro-sensitive, including IT, healthcare, utilities, as well as real estate. So, I think this really underscores the nervousness in the market emanating from geopolitical uncertainty, primarily related to the U.S./China trade war and also how far along we are in the economic cycle.

In terms of the top-performing stocks year-to-date in the TSX, many of them are smaller gold mining companies, which really aren't the kind of high-quality companies that we gravitate towards. The third-best-performing stock year-to-date, Shopify, is up about 130 percent. This company would also not qualify for funds primarily due to the demand in valuation of over about 20 times sales. This stock alone has actually been the largest contributor to the year-to-date returns of the S&P/TSX at over about 100 basis points.

Generally speaking, we've seen a large number of richly valued growth companies continue to contribute meaningfully to the year-to-date returns of the S&P/TSX. Other examples include Constellation Software, Thomson Reuters, CAE, and Dollarama as well. In this environment, investors are willing to pay a premium for perceived quality, as well as earnings stability. As value investors with a quality bias, this has made it more difficult to find opportunities, not just in Canada, but globally as well. As a result, we have elevated cash waiting in our Canadian mandate; as an example, roughly 7 percent in our Canadian Equity and our Dividend Growth Fund. So, we would just rather be patient in waiting for good opportunities and not chase after performance.

Paul Holba, Vice President, Retail Distribution

Great. Thanks, Doug. Albert, currently the market's pricing as much as 75 basis points of Fed cuts by the end of the year. What's the main driver of this and how do you assess risk versus reward for the fixed income market?

Albert Ngo, Portfolio Manager, Fixed Income

Sure, Paul. Since 2015, the Fed has raised rates nine times, and so in the current interest rate environment—the current interest rate is likely around the Fed's neutral rate, which can fluctuate. The Fed very much wants to sustain this economic expansion, and as a result has embraced precautionary insurance cuts in the event the economy weakens. Higher tariffs and increased trade tensions are really increasing the cost of doing business. It's hurting business confidence, and it's putting pressure on businesses' investment. As a result, the risk of a softening global economy has increased, which in turn has driven interest rates lower.

As far as risk versus reward, there's both upside and downside in fixed income markets. First on the downside, currently the 10-year Government of Canada bond yields 1.6 percent, which means government bond investors are not getting paid very much. In fact, if inflation continues at around the 2 percent mark, investors are actually losing purchasing power. Now, the greatest long-term risk to bond prices is the risk of inflation and higher interest rates. Currently, inflation expectations are very low, and if we see an increase in inflation expectations, this could really cause a return of volatility in fixed income. On the upside for fixed income, and particularly government bonds, I think a lot hinges on global trade and its impact on the global economy. If high tariffs and tensions persist, central banks will look to stimulate their economies with lower rates and potentially quantitative easing, which will be supportive for fixed income.

Although we would never recommend that anyone allocates all of their fixed income into government bonds, government bonds will likely act as a hedge and protect an overall portfolio in case of an escalation of trade tensions and/or other geopolitical risks, and as always, government bonds should still be part of any diversified portfolio.

Paul Holba, Vice President, Retail Distribution

So, I suppose 1.6 percent beats what you get in Germany, huh?

Albert Ngo, Portfolio Manager, Fixed Income

Yes.

Paul Holba, Vice President, Retail Distribution

Ian, bond yields are tumbling to record lows. Equities are at record highs. The two big markets are sending seemingly very different messages. How do you reconcile that?

Ian Hardacre, Senior Vice President and Chief Investment Officer

For sure. Thanks, Paul. Yes, as you mentioned earlier, the collapse in bond yields has been stark, swift, and global. Such a move is more common in times of full-blown crisis and by the sharp economic slowdown or recession. Stocks, however, are still hitting record highs. The two markets are taking the same cues, responding to the dovish stance from the central banks hoping for rate cuts. The question, really, is why is the Fed cutting? It is one thing to cut rates to manage inflation targets; it's another to cut, reflects central banks' anticipation of an imminent recession.

In my view, the Fed is cutting for the following reasons. Number one, trade risk. Worsening trade friction may disrupt global supply chains and be a drag on investment. An escalation in trade tensions would add to the risk of an economic downturn in the midterm future.

Number two is slowing global economic activity, particularly on the industrial and manufacturing side. The global manufacturing slump deepened in June. The JP Morgan Global Manufacturing Index fell to its lowest levels since 2012. The new orders' weakening sharply and business optimism at the lowest level on record.

Number three would be lower falling inflation. The challenge for monetary policy really is that it's less effective to address the structural drivers to push down inflation, such as technology-enabled disruption and globalization. The Fed's inflation target has risen only 1.5 percent annually since the financial crisis. Their June meeting officials forecast it would not reach 2 percent until at least 2021.

Number four, which we're familiar with, is political pressure. The Fed is very keenly attuned to continuing the wealth effect. There is a perception that President Trump is pushing Powell. The reality is to some degree is the market's pushing Powell to be responsive to the market, avoiding material negative wealth effects that could reverberate throughout the economy.

Finally, there are numerous global situations at this point of the business cycle. Things like Brexit, Italy's budget dispute with the EU, protests in Hong Kong, the geopolitical tension with Iran, are all risks that could become impactful depending on how things play out.

Paul Holba, Vice President, Retail Distribution

Doug, we mentioned earlier energy having underperformed the overall TSX for the first half of the year, but still remains a very important part of the index, the Canadian economy, especially in Alberta and our Canadian Equities portfolio. So, what's your outlook on oil prices?

Doug Cooper, Senior Portfolio Manager, Canadian Equities

For sure, Paul. WTI or West Texas intermediate oil prices had been very volatile year-to-date. To give you an example, prices increased about 45 percent from the low $40s at the end of 2018 to about the mid-$60s at the end of April this year, and this movement was really the result of easing U.S./China trade tension. From the end of April through the middle of June, WTI dropped over 20 percent to the low $50s, as U.S./China trade tensions flared up again. From the middle of June to today, WTI rallied nearly 15 percent to–I think it's trading WTI at about $58 today, and this was on OPEC Plus extending production cuts through to the first quarter of 2020, and then once again it's de-escalation of the U.S./China trade war post the G20 meetings in Japan.

We expect WTI oil prices to perform reasonably well in the back half of this year, really supported by the OPEC cut extension, as well as geopolitical uncertainty impacting production in key countries, like Iran, Libya, as well as Venezuela. So, we think that these factors likely more than offset U.S. production growth and result in inventory draws in the back half of 2019, which again should support oil prices.

I think the dynamic probably changes in 2020, working against higher oil prices when it will become, in my view, more difficult to offset continued U.S. production growth. Also, the U.S. is likely to apply more pressure on OPEC heading into the U.S. presidential election when OPEC's 1.2 million barrel production cut extension comes up for review at the end of the first quarter of next year.

Paul Holba, Vice President, Retail Distribution

Okay. I want to dig a little bit deeper into oil. You mentioned WTI. How are Canadian oil prices performing, and what's your outlook there?

Doug Cooper, Senior Portfolio Manager, Canadian Equities

Yes, great question. In the back half of 2018, the benchmark for Canadian oil prices, otherwise known as Western Canadian Select, reached historically high discounts to WTI oil prices, really due to lack of takeaway capacity. This discount has narrowed substantially since December of last year. So far, this year has been more in line with historical levels as a result of government-mandated curtailments and then also a ramp-up of crude by rail. We think that these two factors keep the Canadian oil price differential to WTI for the remainder of 2019 roughly in line with where it is today, which would be a positive for Canadian producers.

A couple of other things. We have good visibility on Enbridge's Line 3 pipeline coming online in the back half of next year, which would be another very important factor in addressing Canada's lack of takeaway capacity. Then also, in June, the Canadian government approved the Trans Mountain expansion project pipeline, or TMX, and has planned to start construction as early as this September, which could potentially result in an in-service date by the end of 2022.

So, really, bottom line, while takeaway capacity for Canadian oil remains an issue today, I really do think that things are moving in the right direction, which over time will be supportive of Canadian oil prices, and as a result, the valuations for Canadian producers, which continue to be at historical lows.

In terms of our positioning in energy, we remain conservatively positioned today. Our exposure to energy consists mostly of large cap integrated producers, like CNQ, Cenovus, and then midstream companies as well. We also have companies like Parkland Fuel and PrairieSky, whose free cash flow is much less sensitive through the energy cycle.

Paul Holba, Vice President, Retail Distribution

Thank you, Doug. Ian, the U.S. economic expansion, this month now is the longest in modern American history. It seems to be getting a little old. What's your take on that, and what's the team's strategy?

Ian Hardacre, Senior Vice President and Chief Investment Officer

Sure. Thanks, Paul. Yes, the U.S. recovery has been better than those of other leading developed countries. It is indeed the best-performing developed economy over the past decade since the end of the financial crisis. It is now the longest recovery, but it has been relatively weak by historical standards. The Clinton era boom grew the economy by 43 percent and the Reagan era was 38 percent. The present aggregate growth is only about 25 percent, which annualizes only to a 2.3 percent a year. It is well below the highest annual growth rate, which at 7.6 percent was in the early 50s. U.S. economic growth in the current decade has been the poorest of any 10-year period since 1854, with the exception of the 1930s Depression and the two events we had in the 2000s.

Currently, there are signs of weakness in some areas of the economy. Citi's Economic Surprise Index has been in negative territory throughout 2019, suggesting that some economic indicators are weakening. More recently, the global outlook and uncertainty over trade policies have led to muted inflation and a pullback in business investment and sentiment that were particularly seen out in Europe.

Setting aside core manufacturing activity surveys, the core economic data in the U.S. are far from alarming. Things are actually pretty good for the consumer, and the job market remains strong, as we know. While the consumer confidence has weakened somewhat, wage growth remains strong and could point to continued strength in consumer spending, the primary driver of the U.S. economy. At the end of the day, consumer spending is more than 70 percent of the U.S. economy. So, there are positives for the consumer. Number one is the consumer balance sheet is in good shape. U.S. household net worth and disposable income are on the rise. Debt-to-disposable income is well below the 07/08 levels. There are some issues with auto loan defaults, but in general consumer delinquency data shows global weakness among mortgage, ELOCs, and credit cards.

Two, the labour market has been very solid. Unemployment rate is near a half-century low. Job openings outpace the number of registered unemployed by a record number. In June, there was 224,000 jobs added, which was beyond expectations.

The wider economy has held up reasonably well, but we're starting to see some cracks. We continue to remain cautious in the short term. We will be monitoring as the weakness in the manufacturing sector expands to other parts of the economy.

However, equities enjoyed a boost in valuation from the low bond yields and accommodated central banks. But this year's rally has not been built on top of strong economic outlook of corporate earnings as per last year, and we see a risk to earnings in the coming quarter. There's also trade friction with Mexico. Although Trump has temporarily dropped his threat to impose tariffs, a failure by their southern neighbour to curb migration could revive that possibility, which would be disruptive to the U.S. economy.

Obviously, U.S. politics also warrants some attention. We go day-by-day on that. We might see bigger battles between the parties, including the possibility of another government shutdown this fall, potentially partnered with debt ceiling standoffs or year-end fiscal cliff. As the presidential election politics come to the fore, the rhetoric could also become more heated. We'll look to take advantage of any undue distresses in that as we have in the past.

In terms of strategy, we remain focused on our value-oriented investment philosophy. It's really high-quality, attractively valued companies regardless of the environment. We continue to look for solid businesses trading at discounts to their fair value, and we remain particularly focused on quality of balance sheets and sustainability of free cash flow generation, particularly at this point in the cycle. We believe that owning businesses with these characteristics, driven by durable competitive advantages positions us well for success over the long term, and makes us less concerned about short-term gyration. We're disciplined and selective in our stock picking.

Overall, though, we remain very positive on the long-term prospects for the U.S. economy and equity markets, which are supported by secular tailwinds, including innovation, demographics, and also the energy renaissance in the U.S.

Paul Holba, Vice President, Retail Distribution

Albert, it's an interesting environment. In an environment like this, how do you position a fixed income portfolio, particularly across the–call it the duration in the credit sector?

Albert Ngo, Portfolio Manager, Fixed Income

For strategic corporate bonds, which I manage, we continue to position the portfolio to meet the fund's objectives, which are to preserve capital when interest rates fluctuate or when markets sell off. Two, earn long-term returns meaningfully above inflation by investing in corporate bonds that offer higher yields than government bonds. We're positioned in higher quality, high-yield corporate bonds, as well as investment grade corporates which generate higher yield. We maintain short duration to manage interest rate risk and volatility.

Since the end of Q3 2018, we've seen big movements in interest rates and market sentiment. Going forward, it is impossible to predict the path of interest rates and whether markets will be risk-on or risk-off. However, we're always cognizant of valuations and risk management. In an environment like this, where rates and spreads are both in their historical lows, makes us a little more conservative. However, we think a meaningful allocation to higher-quality, higher-yielding bonds with low duration is warranted, regardless of how future markets unfold, since these kinds of bonds can earn a return well in excess of government bonds with manageable downside risk.

In our main bond fund, we're pretty much duration-neutral. The duration is just slightly shorter than the benchmark. In Corporates, we maintain an overweight position, but we became more defensive as credit spreads came down below their long-term historical averages. The tactical short-term duration trade also added value when yield backed up in April, and we have about 7 percent to 8 percent high yield exposure, primarily to the U.S., which is hedged, helping to pick up more yield. Then also, we have about a 5 percent weighting in preferred shares, which provides diversification in managing interest rate risk and credit risk.

Paul Holba, Vice President, Retail Distribution

Thanks, Albert. Doug, I'm going to turn back to Canada. We really can't talk about Canadian equities without talking about the big banks. Let's go back to you and provide your view on the banking industry.

Doug Cooper, Senior Portfolio Manager, Canadian Equities

Absolutely. As of second-quarter results for the banks, as of the end of May this year, pretty much all the Canadian banks, except for one, maintained its earnings outlook for the current Fiscal Year, which ends in October of this year. Credit market metrics held up reasonably well. The consumer lending growth continues to slow, but other areas of the banks, including commercial loans, wealth management, and capital markets, really offset the decline in consumer lending growth. The most recent quarterly results and outlooks from the banks, I'd say, weren't overly inspirational, but generally in line with expectations, I would say.

We continue to expect the Canadian banks to outperform the broader Canadian equity markets over the long term, as they leverage their strong competitive positioning in Canada. We believe that a credit crisis is unlikely due to the historically high capital levels of the banks, as well as their conservative mortgage book, over half of which is insured by the Canadian government. However, a heavily indebted Canadian consumer will likely continue to weigh on lending growth and push loan losses up to more normal levels. As a result, we expect the growth to be a challenge for the Canadian banks in the short term. However, with the Canadian banks' valuations well below historical averages, with a couple below 2009 financial crisis levels, we do think that most of the macro risks are priced in at these levels. Consequently, we have a meaningful—a material weight in the Canadian banks, with Royal, TD, and Scotia, our top holdings, but we do remain slightly below the S&P/TSX market weight today.

Paul Holba, Vice President, Retail Distribution

Excellent. Several opportunities in the banks, but selective. Can you provide some examples of some other places you've been finding opportunities in the Canadian market in the last 12 months?

Doug Cooper, Senior Portfolio Manager, Canadian Equities

Yes. Definitely, yes. I'll preface my answer by saying that we are bottom-up driven investors, so we do incorporate top-down industry and macro views into our due diligence, but we really focus on finding companies with strong management teams, sustainable competitive advantages, and attractive growth prospects whose share price is trading at a discount to what we think is fair value of that business is.

Looking back over the past 12 months, we have been finding opportunities in non-bank financials, and more specifically companies that are less sensitive to the health of the Canadian consumer and economic growth. One example is Intact Financial, which is a material weight across our Canadian large cap mandate, and this stock has been a substantial positive contributor to fund performance year-to-date.

Intact is the dominant property and casualty, or P&C, insurer in Canada. They have about 17 percent share of the market, which is almost twice the size of its next biggest competitor. There's a number of things that we really like about this business. I think the first thing with Intact is it's run by a very strong management team. So the CEO, Charles Brindamour, has been in his current role for over 10 years, and under his leadership, the company has generated substantial shareholder value. The company also has a long history of outperformance in Canada, and we expect this to continue as it leverages its scale advantage. Moreover, the P&C insurance industry in Canada remains relatively fragmented, which provides a healthy runway for growth. The company also has a long runway for growth in the U.S. via the acquisition of OneBeacon, which is a leading specialty line insurer. Then the specialty line insurance industry is highly fragmented in the U.S., and therefore an area that we think Intact can outperform.

Investor concern surrounding the impact of auto repair cost inflation on Intact's profitability, which peaked in the middle of 2018, gave us an opportunity to buy Intact, roughly 12 months ago, at a very attractive valuation. So, taking a longer-term view and leveraging our deep understanding of the business, we have strong conviction that through price increases and operational improvements, Intact would eventually offset these headwinds and actually accelerate its market share gain. This largely played out in the back half of 2018, as well as year-to-date, which has resulted in strong share price performance. As a result, with valuation kind of moving up to more fair value, we have been recently trimming our position, primarily due to valuation.

Paul Holba, Vice President, Retail Distribution

That's a great example of what we look for and then how we manage a portfolio. So, thank you very much for that. Laurie, if you're there, we're going to open up to questions now from the line. Thank you, gentlemen, for your comments so far today. Laurie, if you can instruct people how to register to ask a question?

QUESTION AND ANSWER SESSION

Operator

Thank you, Mr. Holba. We will now take questions from the telephone lines. If you have a question, and you're using a speakerphone, please lift your handset before making your selection. If you have a question, please press star, one on your telephone keypad. If at any time you wish to cancel your question, please press the pound sign. Please press star, one at this time if you have a question or comment. There will be a brief pause while participants register for questions. Thank you for your patience.

Paul Holba, Vice President, Retail Distribution

Great. Thanks, Laurie. During that brief pause, I'm going to go back to something you touched on a little bit, Doug, which was the value versus growth and the difficulties that bottom-up investors are trying to find the opportunities when it's the high-growth names, like Shopify, that are dominating. What's your thought on that?

Doug Cooper, Senior Portfolio Manager, Canadian Equities

Definitely, that's a really good area to explore. I will say it's been a challenging year so far for Canadian value-oriented investors, such as ourselves. Looking at the numbers, based on MSCI's indices, value has lagged growth in Canada by about 400 basis points year-to-date at the end of June, and this has been an extension of what we saw last year as well. Investment styles tend to drift in and out of favour over shorter periods of time. However, over longer periods of time, value has significantly outperformed growth. I'll put some numbers behind that. Over the past 10 years, the MSCI Value Index has returned an annualized 8.9 percent, while the MSCI Growth Index has only delivered about a 5.5 percent return. That's a real significant difference. I think a U.S./China trade resolution and continued economic expansion could be a real material positive catalyst for value stocks and, more generally, Canadian equities, which tended to skew towards low price-to-earnings, and/or cyclical stocks within the financials, energy, and materials sector. So, even though we've seen a number of richly valued growth companies that tend to be perceived as expensive places to put money, we've been very disciplined with our valuation, and we'd rather just sort of hold a little bit more cash and wait for opportunities to get into higher-quality companies at better valuations.

Paul Holba, Vice President, Retail Distribution

Right. Great. Thank you. Laurie, do we have any questions on the line, please?

Operator

Yes, we do. The first question is from Franco Defazio. Please go ahead.

Franco Defazio

Yes, hi, everyone, from Montreal. I hope everyone's doing well. Fantastic, lots of great information, I appreciate it. My question is really concerning the products offered by Empire Life, like the Class Plus, and how it will be positioned going forward if we do have a major correction going forward in the marketplace, and obviously many clients will say, "Well, I don't care because I've got my bonus, and I've got my income for life." How is that product going to be affected on your shelf of options? Will it be reconsidered, or will it still remain there as one of your leading products in the GMWB family?

Paul Holba, Vice President, Retail Distribution

Franco, I guess I'll take that one because everybody else is sort of looking at me. From a product perspective, from an actuarial perspective, we've done a lot of modeling to ensure that the product that we currently offer is sustainable through many different iterations of what might be able to happen in the market. So, we continue to stand behind that product. In fact, we have a 5 percent bonus rate this year to charge them some additional dollars too. So we're quite happy with the product, quite happy with what it provides to Canadians in terms of a guaranteed income. As we talked about earlier, some of it you'd find in the corporate—government bond funds and GIC rates these days. It's really difficult for people to even keep up with inflation, and you think of—at 2 percent inflation and 2 percent fixed income 10-year rate, after tax, you're losing money. So, this is a good sustainable product for us, Franco. We're quite happy with how it's positioned today.

Franco Defazio

Good. Thank you.

Paul Holba, Vice President, Retail Distribution

Laurie, maybe if you could remind people how to answer questions at this point and—to ask questions, remind me how to answer questions. If you do have some others that can queue up, that would be great. It's a good opportunity to speak with these fine gentlemen.

Operator

Excellent. As I said, once again, please press star, one on your telephone keypad if you have a question or comment.

Paul Holba, Vice President, Retail Distribution

Okay. While we wait for that one, I've got another one that was—people send me questions in advance so I—they're on vacation or they can't make this. The other one was—Ian, this is for you, around U.S. corporate earnings and how our U.S. equities portfolios are positioned as a result.

Ian Hardacre, Senior Vice President and Chief Investment Officer

Sure, Paul. As I mentioned earlier, earnings growth expectations have come down somewhat from last year's double-digit gains, boosted by the Trump tax cut. The combination of trade tensions and some softening of forward-looking industrial data, some stabilization for earnings growth, may be expected as we go forward. The other challenge in the market, responsiveness to Fed's actions and rhetoric, but at the same time, changes in economic stimulus or easing have a lag effect on the real economy. The Fed's previous tightening policies, with the higher rates and the quantitative tightening, are still taking time to pass through the economy. Over the near-term horizon, we do expect some softening of corporate earnings, as we're seeing as we get Q2 earnings, but that's part of what I think leads to both the Fed's caution, and overall our caution on our portfolios, including the U.S. portfolio.

In terms of U.S. portfolio positioning, the equity portfolio is underweighted in consumer discretionary, industrials, and technology. It's a combination of valuation and opportunities that we see. We are slightly overweight in healthcare, communication services, real estate, and utilities, which is a defensive tilt to the portfolio. So, we've added a few healthcare holdings a few months back during the sell-off due to the noise of the Medicare for All as the U.S. election heats up. Those companies have recovered quite nicely. We remain agile on this, simply because during political campaigns, the rhetoric around healthcare will become heated from time to time. So we're more agile, but this from my experience has provided more investment opportunities than many other areas, so we remain focused on that, the healthcare sector in the U.S.

Cash is a little higher than normal. It's typical when markets rally to all-time highs, particularly when it happens quickly. You'll see that among the majority of our portfolios. We have been trimming modestly due to valuations as the market's gone up in the first half. We are seeing fewer opportunities that meet all our criteria, which, as we mentioned earlier, attractive business, secular tailwinds, and attractive valuations. That being said, we have initiated a few new positions in the U.S. fund. There's still opportunities out there, but you have to search harder to find them. All that is in the context, as I mentioned earlier, a defensive tilt to the U.S. portfolio.

Paul Holba, Vice President, Retail Distribution

Ian, I'm going to ask you a follow-up question on the U.S. because we've seen the U.S. markets rally considerably. You also see the Canadian dollar has also rallied. What's the impact of currency and what Canadian investors might be seeing from the U.S.?

Ian Hardacre, Senior Vice President and Chief Investment Officer

There's a combination of things there, Paul. We're unhedged in the U.S. portfolio, for the most part. Some of our cash is held in Canadian dollars, so that's a small hedge. But there is an effect on the portfolios depending on where currently goes. Now, you can look at it on a longer-term basis that a lot of U.S. companies are global companies, so they do have natural hedges within them, and that's a longer-term focus. Some of the companies benefit from movements in the U.S. dollar if they're a global company, but it can have—in the shorter term, it does have somewhat—can have somewhat of a drag on performance, but longer-term currencies do balance themselves out. So, if you have a longer-term view and your clients are holding the portfolio for an extended period of time, currency should work itself out and not matter.

Paul Holba, Vice President, Retail Distribution

Got you. It's just we see the Canadian dollar's $0.76, $0.77 now, and people are going, "Well, what's going on?" So, thank you for that. Laurie, if we have any additional questions on the line, let's go to them.

Operator

Perfect. We do. The first question is from Perry Marchand. Please go ahead.

Perry Marchand

Hi. I just wanted to check, if I were to set up a portfolio today with an 8 to 10-year period, what would the position in my portfolio look like going forward?

Ian Hardacre, Senior Vice President and Chief Investment Officer

Hi, Perry. It's Ian. Obviously, it depends a little bit on your end client and their objectives, but given, I just think of myself as sort of the average client out there, if there's such a thing, I would have a similar mix to the

Canadian asset allocation of funds where you have approximately 30 percent Canada, give or take 20 percent U.S., and about 10 percent equity foreign, and the remainder in a combination of bond and some of it right now for our asset allocation fund is cash as well. It gives you nice blend of—a focus on high-quality Canadian companies, our U.S. American Value portfolio, and then about 10 different global names. So, a combination like that for an average client and then some bonds as well, I think, is a great combination if you look at it over an 8 to 10-year timeframe.

Paul Holba, Vice President, Retail Distribution

I'll just say, too, Perry, we've got several tools that you can use available on our website that are available for you to assess each individual client's needs and what their risk sensitivity might be. If you speak to your local wholesaler, we'd be pleased to show how those work.

Perry Marchand

Yes, okay. Yes, we use them, but I'm just wondering how the asset allocation would look for an 8 to 10-year period for someone who's medium to high-risk. So, the foreign equity is 10 percent, 20 percent U.S., and 30 percent Canadian?

Ian Hardacre, Senior Vice President and Chief Investment Officer

Yes, Perry, it'd be like the same blend as our asset allocation fund right now. I think if you're looking out 8 to 10 years, and you're keeping it relatively consistent, a 30/20/10 blend and then some bonds in addition to that. So, the way that our Asset Allocation Fund is positioned, if it's a situation where it's an 8-year sort of hold, you want to look at it 8 years from now, 8 to 10 years from now, wake up that day and look at it, that would be the right one.

Paul Holba, Vice President, Retail Distribution

Well, it’s worked for 25 years, right Ian, so it should work for another 25.

Perry Marchand

Would you recommend corporate bonds?

Ian Hardacre, Senior Vice President and Chief Investment Officer

I'll let Albert answer that.

Albert Ngo, Portfolio Manager, Fixed Income

Yes, certainly. I think they do provide additional yield versus government bonds. Valuations currently—spreads currently are lower than historical average, but there are still so much opportunities, and we're able to find those. I will say, with corporate bonds, it definitely has to be a bottoms-up approach to finding the right companies with the right balance sheet at the right valuations, but, definitely, I think there always should be an allocation to corporate bonds. I think there always should be an allocation to shorter duration, higher-quality, high-yield bonds. So, absolutely.

Perry Marchand

Okay. Thank you.

Paul Holba, Vice President, Retail Distribution

Thanks, Perry. Laurie, if we could go on to our next question, please?

Operator

Thank you. The next question is from Larry Williams. Please proceed.

Larry Williams

Yes, hi. Good morning. Larry from Vancouver, British Columbia. I just wanted to know, just broadly speaking, what would be some of the bright spots for Canada in the equity markets this year? It seems like there has been so many more opportunities in the U.S., and I'm just wondering what are you guys seeing for Canadian equities?

Doug Cooper, Senior Portfolio Manager, Canadian Equities

Yes. Larry, I'll take that. It's Doug. I'll preface my comments by saying we are bottom-up investors, so we tend to look for the higher-quality businesses that we think are trading at attractive valuations. As per my earlier comment, there are less and less of those opportunities today, just because we have seen a lot of the high-quality businesses get premium valuations in the marketplace, but there are some select opportunities. I will say that energy is definitely interesting. With the big differential between Canadian oil prices and WTI and overall lack of interest in Canadian energy, especially from outside of Canada, U.S. investors specifically, we are seeing a lot of the Canadian energy producers trading at all-time historical lows in terms of valuations. So, we think that's an interesting place, especially in the context of our view that oil prices do fairly well for the back half of this year.

There are some other names outside of energy as well. Saputo is another name that is definitely of interest. It's a pretty big weight across all the portfolios. This is a very high-quality business. The CEO has been in his role for well over 10 years, and he's done a very good job running the business. It's one of those companies that is based in Canada, but it's very global, and it's got a very good track record of acquiring businesses and adding lots of value, and that runway for growth for the business remains very attractive. Short-term, they've been facing some headwinds in terms of the dairy commodity market, but we think those work out over time. So, that's one example of a high-quality business that we think is trading at an attractive valuation.

Larry Williams

Excellent. Thank you.

Operator

Thank you.

Paul Holba, Vice President, Retail Distribution

Thanks for joining us so early, Larry. Laurie, we have one more question?

Operator

Yes, the last question is from Franco Defazio. Please proceed.

Paul Holba, Vice President, Retail Distribution

Welcome back, Franco.

Franco Defazio

Yes. Very interesting. Just a quick take to anyone that wants to take this question. This Robert Mueller testifying at the end of the month, he was supposed to do it, I believe, today, and he's doing it next week. Do you think that may have some repercussions going forward with geopolitical situation with Donald Trump and cause a ripple effect into the market based on what he might say or might not say at the upcoming testimony in front of the Senate?

Ian Hardacre, Senior Vice President and Chief Investment Officer

Franco, good question. The one thing about all these issues with Trump is there seems to be a different event every day. We're dealing with some of the comments that he made recently. I think those hearings will—they'll definitely catch some attention, but as we go forward, the real intention, I think—so they will get some attention, there'll be some noise around them. The market, for the most part, has started becoming a little immune to those type of events. They're definitely not immune to trade issues when it comes to China and Mexico and, to a certain extent, Canada. But I really think the real eyes will be on—as we go forward, closer to the election. Things like those hearings that you mentioned, I mean, I don't think probably will catch a lot of—it won't really affect the markets as much as trade issues and bigger election issues as we head forward and what the Democrats do as well in terms of taking the year.

Franco Defazio

Thank you.

Paul Holba, Vice President, Retail Distribution

Thanks, Franco.

Operator

Thank you.

Paul Holba, Vice President, Retail Distribution

Laurie, I also have a question that's just been emailed to me, so I think we'll wrap that one, and then we'll call it a day. This relates to Emblem. It seems that the Emblem Asset Allocation Committee is making less tactical calls than they used to. Can you review with us some of the recent calls and maybe just share the current asset allocation strategies, Ian?

Ian Hardacre, Senior Vice President and Chief Investment Officer

Yes. Sure, Paul. I do get that question a lot. I think the key thing to remember is we only make tactical movements if there's a good reason to make that move in the portfolio. We don't just make changes for the sake of making changes, but that doesn't mean that they aren't actively managed on a regular basis, as we're always monitoring the portfolios, looking at the economic landscape and looking for opportunities presented by the various asset classes. As a Company, we have a long track record of adding value and making those tactical asset allocation calls. So, even though we've only made a few, it's something we focus on and on a daily basis. When I looked at them last November, when markets were going lower, we tactically increased the U.S. and international equities by putting some cash to work in one of the worst selloffs in recent years. The most recent move made was in April when we shifted some of the equity exposure from the international funds to the U.S. Both moves are proven timely, and they were effective—the year-to-date allocation effect added between 45 and 120 basis points, depending on which Emblem portfolio you're looking at.

So, when I look at those asset allocation calls, I'm really looking for quality versus quantity, and I think that's something that everybody's thinking about. Overall, we remain overweight equities and underweight fixed income. In our view, U.S. equity markets offer us an advantage in the current late-cycle environment. It's a balance between continued growth and the defensive characteristics. Our U.S. equity sleeve is comprised, as I mentioned before, of high-quality companies, strong balance sheets, competitive advantages.

So, we maintain U.S. equities overweight at the expense of international equities, and that positioning, historically, is considered more defensive. We're neutral on Canadian equities. The position in high-quality–what I believe are incredibly inexpensive stocks in Canadian equities right now. The cash held in the portfolio, which we do have some depending on the Emblem portfolio of between—well, today would be about 7 percent to 8 percent, is really what I'd call a residual to the process. It allows us to take advantage of opportunities when they're presented, which has worked to our benefit over a complete cycle.

Lastly, I'm just going to add, very confident in our positioning in our portfolios. High-quality companies, well-managed businesses trading below our determination of intrinsic value.

Paul Holba, Vice President, Retail Distribution

Great summary. That's exactly what we do. If anybody wants to know how we manage money, that is it. Laurie, while there are no further questions, thanks for managing that process for us. Firstly, I'd like to thank Ian, Doug, and Albert for providing their insights on the markets and current events today. Thanks, everybody who took the time to call in and particular those of you that asked the questions.

This investment team continues to find investment opportunities in all market cycles, and Ian just pointed out some great opportunities we see today.

Please stay informed on the investment activities of this team. We've got our investments blog. We've got our Emblem Portfolio Asset Allocation Updates. We do our Portfolio Manager interviews. We've done some media work. We also have the newsletter that Ian's sending out, "From the Desk of Ian Hardacre," which I thought was well-titled, since it was coming from your desk. All of this is at empirelifeinvestments.ca.

I'm also going to just give you a heads-up. We are planning a road show in September and October, so look for information on that coming out shortly to save some dates for you as we crisscross the country and share some of the stories that we have and some news on some products we have and that we're making.

If you do have any questions about today's call, or any questions at all about our products—we had some questions today about Class Plus, we have some other interesting opportunities out there in terms of compensation enhancements around our GIF products. If you're not familiar with that, please contact your Empire Life sales team. We would love to come and talk to you, and to figure out how we can best work with you to invest into your business.

This conference call and a transcript is going to be posted to our website probably early next week. We'll then send an email blast to all of our advisors, so you can listen to it again at your leisure, or if you did have some colleagues who are on vacation or busy in meetings today and missed the call, then you could pass it along to them as well. I think you'll agree there's been a lot of information. There's great information that's been shared here today

Again, I thank you very much for calling in. Enjoy the rest of the summer, and we'll see you in the fall. Laurie, this will end our call today. Thanks, everybody.

Operator

Thank you, Mr. Holba. The conference call has now ended. Please disconnect your lines at this time. Thank you for your participation.

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* Morningstar is an independent organization that groups funds with generally similar investment objectives for comparison purposes and ranks them on a historical basis. Morningstar Ratings reflect performance as of June 30, 2019 for Classes A and G units and are subject to change monthly. The ratings are calculated from a fund's 3, 5 and 10-year returns measured against 91-day Treasury bill and peer group returns. For each time period the top 10% of the funds in a category get five stars, the next 22.5% four stars; the following 35% three stars; the next 22.5% two stars, and the bottom 10% one star. The Overall Rating is a weighted combination of the 3, 5 and 10-year ratings.

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