Empire Life Emblem Portfolios: Asset Allocation Update

Update from the Asset Allocation Oversight Team

January 14, 2016

Summary of Asset Allocation Decisions

Asset Class	Current Asset Allocation Positioning
Fixed Income	Neutral
Canadian Equity	Underweight
U.S. Equity	Overweight
International Equity	Underweight

	Neutral Allocation*				Current Target Allocation (change from prev.)			
Emblem Portfolio	Fixed Income	Canadian Equity	U.S. Equity	International Equity	Fixed Income	Canadian Equity	U.S. Equity	International Equity
Diversified Income	80.0%	10.0%	5.0%	5.0%	78.5% (+3%)	8.0% (-1.5%)	8.5% (-1.5%)	5.0%
Conservative	65.0%	25.0%	5.0%	5.0%	64.5% (+4.5%)	16.0% (-3.5%)	14.5%	5.0% (-1%)
Balanced	50.0%	35.0%	7.5%	7.5%	49.5% (+2.5%)	25.0% (-1.5%)	20.0%	5.5% (-1%)
Moderate Growth	35.0%	45.0%	10.0%	10.0%	34.5% (+3%)	36.0% (-2%)	23.5%	6.0% (-1%)
Growth	20.0%	60.0%	10.0%	10.0%	19.0% (+3.5%)	49.0% (-1.5%)	25.0% (-1%)	7.0% (-1%)
Aggressive Growth	-	75.0%	12.5%	12.5%	-	60.0% (-3%)	31.0% (+3%)	9.0%

*Neutral allocation is based on the Fund's respective long-term strategic asset allocation

Rationale

Key takeaway: Tactically Increased Fixed Income, Decreased Equities

Tactical View:

2016 welcomed equity investors with a cold shoulder. As at January 14, the S&P/TSX Composite closed down 5% on a year to date basis (YTD), and down 12% from its high on October 9th, 2015. In the U.S., the S&P 500 closed down 6% YTD and down 9% from its November 3rd, 2015 high. However, an appreciation of the U.S. dollar versus the Canadian dollar buffered some of those declines for Canadians.

In fact, the Canadian dollar's rapid decline to $0.70 put the exchange rate into territory not seen since 2003. The recent decline has been highly correlated with the price of oil, which deteriorated from about $50 U.S. per barrel to about $30 in only three months due to supply and demand factors. The negative spillover effect to the overall Canadian economy remains a risk, increasing the likelihood that the Bank of Canada will need to further decrease interest rates to support the economy. This would be supportive to the Canadian bond market.

Although equity valuations remain somewhat in overvalued territory, we do not believe they are at levels that would typically signal a protracted bear market. The S&P 500 12-month forward P/E ratio is about 16.4 vs a 25-yr average of 15.8, slightly higher, but not over-stretched. Aggressive central bank tightening (increasing interest rates) has also been a precursor to major bear markets, which is not a scenario that we expect, as the U.S. Federal Reserve has telegraphed their intent to remove monetary stimulus at a gradual pace.

We remain positive on equities mid to longer term, but view the current correction as an opportunity to invest at more attractive valuations in the year ahead. As a result, target allocations to fixed income have been tactically increased, and equity target allocations decreased. In the equity oriented Empire Life Emblem Aggressive Growth Portfolio, the target allocation to U.S. equities has been tactically increased at the expense of Canadian equities, given the U.S. market's more defensive nature, particularly when factoring in currency effects.

Empire Life Investments

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