Empire Life Emblem Portfolios: Asset Allocation Update

Update from the Asset Allocation Oversight Team

March 11, 2014

Summary of Asset Allocation Decisions

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

	Neutral Allocation*				Target Allocation – March 11, 2014			
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%	77.0%	10.0%	8.0%	5.0%
Conservative	65.0%	25.0%	5.0%	5.0%	60.0%	21.5%	12.5%	6.0%
Balanced	50.0%	35.0%	7.5%	7.5%	44.0%	31.0%	17.0%	8.0%
Moderate Growth	35.0%	45.0%	10.0%	10.0%	29.5%	42.5%	18.0%	10.0%
Growth	20.0%	60.0%	10.0%	10.0%	14.0%	58.0%	18.0%	10.0%
Aggressive Growth	–	75.0%	12.5%	12.5%	–	65.0%	22.5%	12.5%

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

Rationale

- Bond investors caught a slight reprieve to start the year as demand for safety increased on reignited emerging market fears, and more recently, on Ukrainian tensions. Our view is that the consensus driver behind this latest yield move is more reactionary and not fully based on fundamentals. From a technical point of view, resistance to further bond market gains comes from yields hovering close to the low end of its half-year long range. **As a result, we have modestly widened our underweight position towards fixed income.**
- Although the Canadian equity market delivered good returns in 2013, they substantially lagged global equities. This was partially due to stronger foreign currencies, but also due to a wide disparity in Canadian sector performance. The Materials sector particularly underperformed as gold prices sharply retreated. Canadian small cap equities bore the brunt of this disparity due to that segment's larger weighting in mining stocks. For 2014, we believe these disparities are likely to narrow, as last year's laggards may potentially experience an oversold rally. Additionally, we would not be surprised to see Canadian small cap stocks outperforming large caps over the near term. **As a result, we have moderately narrowed our underweight position towards Canadian equities through investments in what we believe to be higher quality small cap stocks.**
- U.S. equities shone in 2013, driven by an improving domestic economy, rising corporate profits, and continued accommodative policies from the Federal Reserve. The pattern of gradual growth with benign levels of inflation has often been described as a "Goldilocks" economy (not too hot, not too cold). The latest round of corporate profits shows that about 70% of S&P 500 companies surpassed analyst profit expectations, and 60% have surpassed revenue expectations*. Lastly, the stock market's generally positive reaction to the gradual reduction (or tapering) of the Federal Reserve's asset purchase program, as well as the central bank's leadership transition from Ben Bernanke to Janet Yellen, adds further confidence that monetary policy continues to be on the right track. **As a result we have maintained our overweight position towards U.S. equities.**

  * source: Factset (February 28, 2014)

Empire Life Investments

- International equities also performed very well in 2013, led by Japan in the first half of the year, then by Europe over the second half. Japan's earlier performance was driven by their government's aggressive economic growth policies, otherwise known as Abenomics. However, part of this plan targets debt reduction, partially through a series of consumption tax increases, the first of which is scheduled to take effect next month. Investors have become concerned of its effect on the country's fledgling emergence from years of deflation. While we cannot predict the full implications of this event, we believe any negative Japanese stock market reaction is likely to correspond with an increase in the Japanese yen, thereby providing a performance offset for Canadian investors. In Europe, we are vigilantly monitoring Ukrainian developments and its potential spillover effect into equity markets. At the time of writing, we do not believe they have escalated to the point of requiring meaningful action. **As a result, we remain neutral towards international equities.**

Important Information

Empire Life Investments®