

Empire Life Emblem Portfolios: Asset Allocation Update

Update from the Asset Allocation Oversight Team

May 28, 2013

Summary of Asset Allocation Decisions

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

Emblem Portfolio	Neutral Allocation*				Target Allocation – May 28, 2013			
	Fixed Income	CDN Equity	U.S. Equity	International Equity	Fixed Income	CDN Equity	U.S. Equity	International Equity
Conservative	65.0%	25.0%	5.0%	5.0%	60.0%	22.5%	12.5%	5.0%
Balanced	50.0%	35.0%	7.5%	7.5%	45.5%	32.0%	15.0%	7.5%
Moderate Growth	35.0%	45.0%	10.0%	10.0%	30.5%	42.0%	17.5%	10.0%
Growth	20.0%	60.0%	10.0%	10.0%	15.5%	57.0%	17.5%	10.0%
Aggressive Growth	—	75.0%	12.5%	12.5%	—	70.0%	20.0%	10.0%

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

Rationale

- Supported by improving U.S. economic indicators, continued aggressive reflationary policies in Japan, and a settling of headline risks emanating from Europe, equity markets continued their spring rallies, highlighted by the new highs reached by the S&P 500 during the first half of May. Despite the advance, equity valuations continue to be viewed as attractive in most developed markets, as earnings gains have partially offset some of the price gains.
- Comments made on May 22 by Ben Bernanke, chair of the U.S. Federal Reserve (the Fed), were interpreted by the bond market to mean the pace of the Fed's bond purchases would decrease sooner than expected. This would likely remove a meaningful source of support for the bond market. This, combined with improved investor sentiment and economic conditions, drove bond yields sharply higher – and prices lower – during May, with the ten-year Government of Canada bond trading close to its ten-month low. Given the risk that bond yields may continue to move higher over the near term, we further decreased allocations to bonds in select portfolios.
- Following a sharp decline in energy and gold mining companies during the first half of April, the S&P/TSX Composite regained most of its losses by the end of May, after gold and oil prices stabilized, but continued to trail other developed markets on a year-to-date basis. As we head into a seasonally weaker period for equities, we believe Canadian equities offer an attractive risk profile, compared with other markets that have advanced meaningfully in a short period of time. Canadian equities are also viewed as being more attractive than Canadian bonds from a yield and risk-adjusted return perspective. As a result, we increased allocations to Canadian equities in select portfolios, although still remaining underweight, relative to the Portfolio's benchmark.
- Support for U.S. equities continues to be driven by generally positive economic developments. The U.S. unemployment rate declined to 7.5%, jobless claims continued their steady downtrend, and the S&P/Case-Shiller Home Price Indices saw annual increases of over 10%, reflecting the largest annual gains since 2006. On the earnings front, approximately 69% of S&P 500 companies beat analyst earnings estimates during the most recent reporting period. Should equity markets retrace some of their recent gains over the summer months, we believe exposure to the U.S. dollar should buffer some of those losses. We remain overweight in U.S. equities.

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- Overseas markets have been led by Japan, following aggressive reflationary policies by Prime Minister Shinzo Abe. However, on May 23 the Nikkei 225 Index suffered its largest single-day loss (down 7.3%) since the 2011 earthquake and tsunami, perhaps triggered by pent-up intentions of profit taking. As Europe works through its second recession since 2009, its equity markets have provided respectable returns on a year-to-date basis, with the markets of the troubled countries (such as Italy and Spain) trailing the markets of Germany, France, and the U.K. However, a shadow looms on the horizon for the region, in the form of German federal elections in September. We remain neutrally weighted in international equities.

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