Empire Life Emblem Portfolios: Asset Allocation Update

Update from the Asset Allocation Oversight Team

September 15, 2014

Summary of Asset Allocation Decisions

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

	Neutral Allocation*				Target Allocation – September 15, 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%	76.5%	9.0%	12.0%	2.5%
Conservative	65.0%	25.0%	5.0%	5.0%	61.0%	22.5%	14.0%	2.5%
Balanced	50.0%	35.0%	7.5%	7.5%	46.5%	32.0%	17.5%	4.0%
Moderate Growth	35.0%	45.0%	10.0%	10.0%	31.5%	42.0%	21.5%	5.0%
Growth	20.0%	60.0%	10.0%	10.0%	16.5%	56.0%	22.5%	5.0%
Aggressive Growth	-	75.0%	12.5%	12.5%	-	70.0%	24.0%	6.0%

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

Rationale

Key takeaway: Increased U.S. equities; decreased international equities

Over the first eight months of the year, Canadian bond markets performed well, with the FTSE/TMX Canada Universe Bond Index returning 6.6%. This is perhaps surprising, given the negative sentiment regarding bonds at the beginning of the year. Recent strength has been driven by an attractive yield premium for Canadian and U.S. federal bonds over comparable European sovereign bonds. With Canada's ten-year bond yield currently more than double that of Germany's, and on par with Spain's – a country with a much lower credit rating – it could be argued that Canadian bonds still hold relative value. **However, we believe current fundamentals remain favourable for equities, particularly in the U.S. As a result, we remain underweight in fixed income.**

Equity markets in North America have been good to investors thus far in 2014, with major indexes reaching multiple new highs, with very little volatility. The S&P/TSX Composite Index returned 17%, without any pullbacks of over 5%, while the S&P 500 Index returned 10%, with only one pullback of over 5% along the way. Economic data in the U.S. have been choppy, particularly given the effects of a brutal winter season, but the bigger picture reveals continued improvements. Despite the well-telegraphed winding down of the Federal Reserve asset purchase program, monetary policy under Janet Yellen remains very supportive for expansion, with continuing slack in the labour market and tame inflation being cited as key factors. Additionally, the U.S. dollar has seen recent strength against its major trading partners, a trend we believe will likely continue due to relative economic strength, and as the date of the first increase in the Federal Funds rate approaches.

The same cannot be said about international markets. Europe continues to struggle economically, with deflation a real threat in the region. This is perhaps best reflected in the region's very low sovereign bond yields (as mentioned above) and a declining euro currency against the U.S. dollar. Revival attempts by the European Central Bank (ECB), such as setting negative interest rates and implementing a targeted loan program, have not instilled lasting confidence among investors. The ECB has indicated preparations are under way for outright asset purchases, a move that may provide support not only for European equities but also North American equities. However, that move may lead to further weakness in the euro currency, partially offsetting any European equity gains for foreign investors (much like the case in Japan in early 2013).

As a result, we remain overweight in equities, and we have increased target allocations to U.S. equities and decreased target allocations to international equities. Canadian equities remain underweighted.

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