Empire Life Emblem Portfolios: Asset Allocation Update

Update from the Asset Allocation Oversight Team

October 25, 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

	Neutral Allocation*				Target Allocation – October 25, 2013			
Emblem Portfolio	Fixed Income	Canadian Equity	U.S. Equity	International Equity	Fixed Income	Canadian Equity	U.S. Equity	International Equity
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%	45.0%	30.0%	17.0%	8.0%
Moderate Growth	35.0%	45.0%	10.0%	10.0%	31.5%	40.5%	18.0%	10.0%
Growth	20.0%	60.0%	10.0%	10.0%	17.0%	55.0%	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

- The term "kicking the can down the road" has been commonly used by the media to describe the U.S. government's strategy of leaving their debt and budgetary issues for another day. With that can kicked forward again until early next year, the Federal Reserve's tapering off of their asset purchase program (also known as Quantitative Easing or Q.E.) is likely to be delayed as well. With these fiscal and monetary headwinds diminishing over the near term, it is our view that markets are likely to end the year on a similar pattern that has unfolded thus far, with equities outperforming fixed income and foreign equities outperforming domestic equities.
- Bond yields have declined meaningfully since early September, partially driven by the Federal Reserve's surprise announcement at its last Federal Open Market Committee meeting to not taper its pace of Q.E. We believe yields are now close to the bottom end of a slowly rising range. As a result, we modestly widened our underweight allocation to fixed income (cash and bonds) in favour of equities.
- Canadian equity performance picked up over recent months, particularly following the U.S. debt and budgetary compromise. With market sentiment now less risk averse in the short term, our Canadian equity investments were modestly adjusted to leverage more cyclical opportunities. However, as we believe foreign equities are likely to show better relative strength over the near term, we remain underweight in Canadian equities.
- U.S. equities also performed strongly following the debt and budgetary compromise. In our view, politicians are fighting yesterday's war simply for bragging rights. In reality, the economy continues to improve, resulting in a stabilizing debt to GDP ratio. Additionally, the deficit continues to shrink due to decreased government spending and increased tax revenues. We expect the Federal Reserve's pace of stimulus to remain on hold in order to offset the risks caused by further political noise that is likely to resurface early next year. As a result, we have increased our overweight position towards U.S. equities.

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- Confidence in Europe's recovery from recession continued to gain traction, as evidenced by a strong rally in the Euro currency over recent months. Further support for the region came from Angela Merkel's victory in the German elections, confirming that country's confidence in one of the key architects of the region's recovery plan. However, further appreciation in the currency beyond $1.40 (USD) could place a drag on exports and risk the fragile recovery. In Japan, further progress hinges on the effectiveness of Prime Minister Abe's social reforms which is likely to face the most resistance among his "3 arrow" growth strategy. Although risks remain for this asset class, market expectations also remain relatively low, presenting an attractive value opportunity. As a result, we have increased our allocation to international equities.
- With these macro level driven strategies intended on adding incremental value, it is important to keep in mind that our bottom-up, value oriented security selection process remains at the heart of our investment process. We believe a focus on high quality security selection at reasonable prices will result in competitive performance with downside protection.

Important Information

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