Empire Life Emblem Portfolios: Asset Allocation Update

Update from the Asset Allocation Oversight Team

September 9, 2013

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 9, 2013			
Emblem Portfolio	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%	33.0%	42.0%	17.0%	8.0%
Growth	20.0%	60.0%	10.0%	10.0%	18.0%	57.0%	17.0%	8.0%
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

- With impressive gains in equity markets for the year, particularly in developed markets outside Canada, we view the risks of a short-term pullback to be real. Other potential risks stemming from an escalating crisis in Syria, weakness in emerging market securities and currencies, and a seasonally weak period for equities provides further impetus to lock in some gains on the year.
- Bond yields rose significantly over the summer months as debate continued surrounding the timing and magnitude of the U.S. Federal Reserve's intent on tapering its asset purchase program, also known as Quantitative Easing (or QE). Although we believe the ultimate direction for bond yields over the medium term remains higher, current yields likely reflect much of the yield back-up that the Federal Reserve would be comfortable with over the shorter term. Therefore, further deterioration in bond markets is likely limited, barring unforeseen shocks. Given this development, combined with near term risks in the equity markets, allocations to fixed income (cash and bonds) increased modestly, resulting in a narrower underweight position towards the asset class relative to its strategic asset mix benchmark.
- Canadian equity markets have lagged other major developed markets this year, as our resource-centric market faced commodity price headwinds, particularly towards precious metals. At the end of August the S&P/TSX Composite Index added less than 4% for the year, compared to double digit gains for the S&P 500 and MSCI EAFE indices (accounting for currency effects). Looking forward, higher oil prices driven by the Syrian conflict can benefit Canada's energy sector, and improving economic data coming from China may benefit other Canadian resource companies. Additionally, Canadian equities are typically stronger over the latter part of the year. Given these dynamics, allocations to Canadian equities were modestly increased, resulting in a narrower underweight position towards the asset class relative to its benchmark.
- Economic releases over the summer months further substantiate the U.S. economy's continued recovery from its Great Recession. Initial jobless claims fell back to levels prevailing since before the Financial Crisis, and home prices experienced double digit annual gains not seen since 2006. However, with an impressive 23% gain over the first eight months of the year in Canadian dollar terms, the S&P 500's pace is likely unsustainable and potentially at risk for short-term weakness in our view. Near term risks include budget and debt ceiling debates, QE tapering details, and seasonal weakness. We remain overweight U.S. equities, but have modestly realized some of the gains in the asset class.

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- Initial readings signal the Eurozone may have emerged from recession in the second quarter this year with renewed strength from exports and spending. Risks to the financial system have also improved as evidenced by narrower bond yield spreads between German issues and those of troubled nations such as Italy and Spain. Progress in Japan's attempt to revitalize their economy seems to have temporarily stalled with a divided view between the government and the central bank towards increasing its value added tax. As well, investors await further details on their plan towards social reforms. Nonetheless, the MSCI EAFE Index advanced almost 15% for the year (to August 31st in Canadian dollar terms). This likely reflects much of the near term positive fundamental developments for the region. Given the fundamental risks that remain on the table and a seasonally weak period for equities, allocations to international equities were modestly decreased on a tactical basis.

Important Information

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