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## Staying on the right track

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Stock markets were incredibly calm in 2017 with low volatility and few down days. This year has been different. Global markets corrected in February and have been weak since, with the exception of the U.S. market. Emerging markets, as represented by the MSCI Emerging Markets Index, have fallen approximately 18% from their peak in January. Several emerging economies are entering recession.

Market leadership has been concentrated in consumer technology (Apple), e-commerce (Amazon) and cloud services (Microsoft) leading market growth in the third quarter. To put this concentration in perspective, Apple's contribution to the S&P 500 Index return was more than the combined contribution of *all* companies in the following seven sectors: financials, consumer staples, energy, utilities, real estate, materials and telecommunications. Investors who did not own Apple stock or owned less than Apple's average weight in the S&P 500 Index (4.2%) missed out on the growth.

In our view, the risk of volatility is increasing. Our portfolios are not only positioned to optimize returns, they are also built to weather volatility. We regularly review our portfolios and make enhancements when opportunities arise. After a recent review, we are enhancing our portfolios in two ways.

### **1. Asset mix change**

We continue to monitor both the fundamentals of economies and valuations of the markets to position our portfolios for strong risk-adjusted returns. We are reducing exposure to credit markets and simultaneously increasing weightings of sovereign bonds. Both markets have gone to extremes. Sovereign bonds used to offer negative real yield for many years after the financial crisis in 2008-09 and are now offering positive real yield. Credit premiums have fallen from their peak in 2009 and are now at historical lows. These metrics suggest that credit is overvalued and sovereign bonds are at least at fair prices. In the equity portion of the portfolios, we are taking profits from U.S. equity and international equity to increase our exposure to Canadian equity. Canadian equity has trailed the performance of its global peers in the recent rally. While there are long-term structural challenges such as a lack of available companies and sectors in which to invest, valuations have become attractive as investors have largely neglected this market. Low expectations and low valuations are a recipe for higher potential return.

## 2. A new strategy: Global Equity Allocation Pool

We are launching Global Equity Allocation Pool to serve two purposes:

### *1) Allow easier implementation of asset mix adjustments to your portfolios*

Our current method for changing your asset mix involves buying and selling the underlying pools in your portfolio. With the introduction of Global Equity Allocation Pool, changes can be made within the new pool to achieve the same result while saving time and potentially deferring taxes that may otherwise be triggered in your account.

### *2) Capture opportunities by investing in smart beta or market factors*

The Pool will invest in factors such as: value, growth, momentum, low volatility, quality and high dividend. Portfolio returns are generally explained by asset mix and stock selection decisions. Within stock selection, the factor of a stock plays a role in performance. By actively selecting the factor(s), we could achieve low volatility and/or added value versus the benchmark. This strategy complements the fully detailed fundamental analysis performed by our portfolio management teams.

We believe these enhancements will position our portfolios to benefit from changing market conditions in a more efficient way.

*Combined top 15 equity holdings as of September 30, 2018 of the Evolution 40i60e Standard portfolio with Alpha-style exposure:*

1. SNC-Lavalin	6. Toronto-Dominion Bank	11. Apple
2. Atco	7. Canadian Pacific Railway	12. CSX
3. Gilead Sciences	8. Microsoft	13. E-L Financial
4. Alphabet Class A	9. Industrial Alliance	14. Bank of Nova Scotia
5. AltaGas	10. Magna International	15. Finning Tractor