iA Investment Watch

Economic and Market Overview and Featured Funds

For advisor use only

Quarterly / **May** / 2016

Clément Gignac

Economic and Market Overview

International

Many events made the news since the beginning of the year. First, OPEC showed some willingness to stabilize oil prices by putting forward a proposal to freeze production, as long as all its members (a request targeting Iran, which is looking to bring back production to the levels reached prior to the imposition of economic sanctions linked to its nuclear program) and other oil-producing countries cooperate. Second, China made it clear that it was not looking to further devalue its currency, which would have injected a massive dose of uncertainty into the economy and the markets. Rather it will target a stable currency versus a basket of trade-weighted currencies. All in all, we still believe that fears of a global recession were exaggerated and that the global economic landscape remains solid, although without any fireworks.

Europe

The new year came with new monetary stimulus measures in Europe. Although the economic data has shown some modest signs of improvement, the European Central Bank (ECB) remains concerned about the threat of deflation and therefore deemed it necessary to add more credit-easing measures to prime the credit cycle. The benefits, if they materialize, should be felt in the expansion of credit to SMEs. Whatever happens, the ECB is clearly writing a new page in the history of monetary policy.

United States

Much of the market volatility at the start of the year was tied to recession concerns in the United States in 2016. This idea, conveyed by several market analysts but which is very unlikely to materialize, emerged primarily in reaction to the manufacturing sector weakness observed in late 2015 as well as the sharp drop in interest rates, viewed by many as a precursor to a recession. The top world economy is still feeling the effects of the rapid climb of the dollar over the last few years, which weighs on the sales of export companies and multinationals, but the domestic economy is in excellent shape, as can be seen from the labour market that continues to create jobs at a pace of over 2 million per year.

Canada

Although the oil-producing provinces are still suffering the repercussions of low oil prices, the hope of returning to a more diversified economy through a shift to the manufacturing sector seems to be materializing. More and more data points in this direction: full-time job creation has migrated toward British Columbia, Ontario and Quebec, the three provinces benefitting the most from the loonie's decline. Manufacturing deliveries also began the year on strong footing, as did exports of non-energy goods. In a context where U.S. economic growth remains solid and the Canadian dollar sits below its long-term equilibrium level (which is around 83 to 85 cents), the transition of the Canadian economic model should continue.

/ Strategy

Despite all the volatility seen during the first quarter, our overall strategy has remained the same, with a few minor adjustments. We believe the Canadian stock market offers an attractive valuation and that the stabilization of oil prices around $40 per barrel is sufficient to revive international investors' interest in the Canadian stock market. The U.S. stock market is valued slightly above its historical average, and should generate positive returns in 2016, though inferior to those of the Canadian market. We are maintaining a target of 70 to 80 cents for the Canadian dollar this year and sticking to our currency hedging strategy.

iA Financial Group

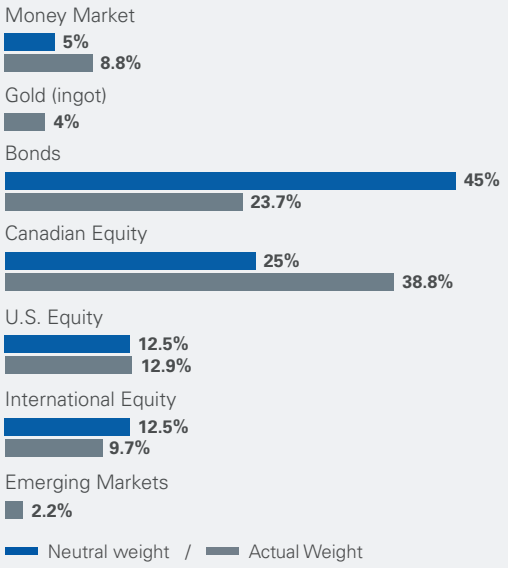
/ iA Managed Solutions

Diversified Funds

We stayed the course with a strategy of overweighting equities in the first quarter, and took advantage of a few opportunities provided by the market volatility. Canadian equities now account for 38.8% of the Diversified Fund, of which 8% are in small-cap stocks. Foreign equities now represent 26% of fund assets, which is 1% more than at the end of the previous quarter.

Bond weights remain under target, at 24% versus a target of 45%, the same level as at the end of the previous quarter. The cash balance now accounts for nearly 8.8% of the fund's assets, and we no longer hold any direct exposure to the U.S. dollar.

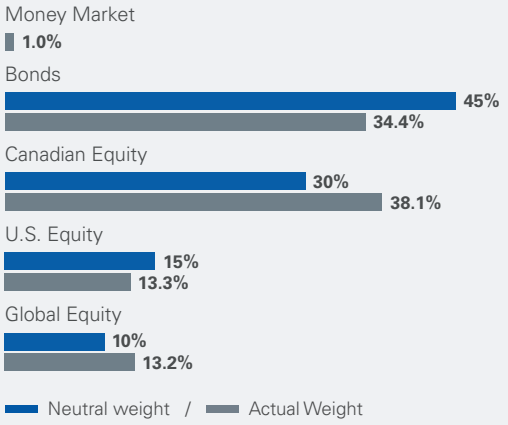
Finally, we initiated and maintained direct exposure to the price of gold, through forward and futures contracts on the price of gold bullion and exchange-traded funds (ETFs) containing gold stocks. The current context of highly accommodating monetary policies and the threat of an upsurge in U.S. inflation provides an ideal environment for the return of the yellow metal as an asset class prized by international investors, as seen in the noteworthy performance of the price of gold since January.



Selection Funds

The Selection family of funds continues to have an above-neutral exposure to equities, by about 9%. Changes made in the first quarter aimed at hiking exposure to Canadian equities, which saw its weight jump from 6% to 8% in the Selection Balanced fund, and lowering the weight of U.S. equities and global equities.

We remain careful towards fixed income securities, but in a lesser way, by cutting the underweight to 9.25%. Cash was reduced to 1% as we capitalized on opportunities offered by the market pullback early in the year.



Focus Funds

A family of five funds, made up of various sub-funds, with asset allocations and risk profiles that correspond to each investor profile. Focus funds are for investors who want their portfolio to reflect their risk tolerance at all times (with monthly rebalancing), regardless of the economic environment.

/ Featured Funds

Available starting May 16

Canadian Corporate Bond

Offered in: IAG SRP (Classic Series 75/75 & Prestige, Series 75/100 & Prestige), My Education+ & Prestige preferential pricing, and Ecofl*extra* Classic Series 75/75

Portfolio manager

Industrial Alliance Investment Management Inc. (iAIM)

CIFSC Fund Category

(Canadian Investment Funds Standards Committee)

Canadian Fixed Income

Lead portfolio manager

Pascal Garneau, CFA

Along with 5 investment professionals dedicated to corporate credits

- Director, Corporate Credits, Fixed Income
- Joined Industrial Alliance in 2002 (close to 20 years of investment experience)
- Degree in Business Administration (Laval University)
- Manages over $7 billion in assets

Why consider this fund?

— Attractive yields: Investment Grade Corporate Bonds (BBB- and above) offer a higher yield-to-maturity (3.5x higher) than Canadian Government bonds

— Lower interest rate sensitivity: corporate bonds typically exhibit a lower sensitivity to interest rate movements than government bonds

— Low credit risk: low historical default rate

— Diversification benefits: the large number of corporate issuers allows for diversification across various industries and sectors

— Lower volatility: the inverse relationship between credit spreads and interest rates, combined with the asset class' shorter duration, result in lower volatility

— Better risk/return profile: higher yields combined with lower volatility translate into better risk-adjusted returns

Investment style & other characteristics

— Approach consisting of ≥90% investment grade corporate bonds combined with 0–10% of tactical positions in other types of credit instruments manager considers attractive (high yield, U.S. corporate bonds, etc).

— Diversified portfolio of 70–80 holdings, across 40+ issuers

— Focus on credit quality and liquidity in order to keep flexibility

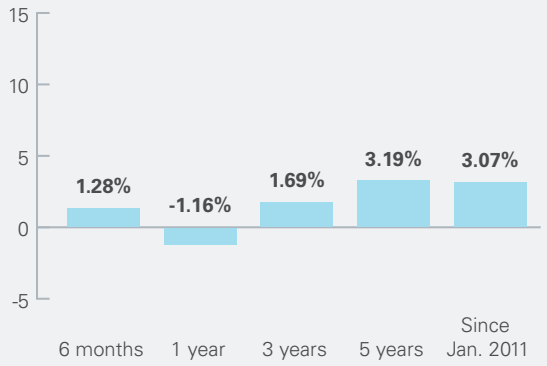
Current Fund strategy

The team continues to believe that investment grade corporate bonds should perform well in the upcoming year. The latest dovish decisions of major central banks should keep interest rates low and corporate bonds should attract yield-hungry investors. However, increasing leverage ratios and the rising weight of BBB issuers in the Canadian Corporate Universe signal that the current credit cycle is in the late stage of its expansion phase. Current spread levels are attractive and compensate investors adequately for the incurred credit risk. In addition, the typically inverse rate/spread relationship provides some protection against rising interest rates. In the short run, however, oil price movements and central banks' policies will continue to drive market movements.

The Fund's sector positioning continues to overweight the telecommunication and financial sectors while underweighting energy, infrastructure and real estate. On the credit spectrum, the Fund is overweight BBB and underweight AA to profit from the higher carry and potential spread tightening of BBB-rated securities. Nevertheless, with over 50% of invested assets rated A or higher, the Fund's core holdings are focused on liquidity and credit quality in order to be able to react to rapidly changing market conditions. In the coming months, the portfolio management team will continue to monitor key market drivers and optimize the fund's positioning to maximize return without taking undue risk.

Canadian Corporate Bond

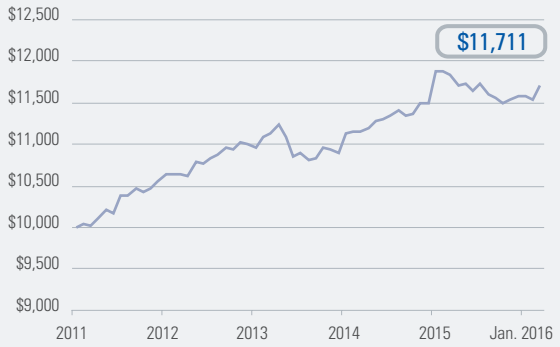
Net compound returns[1]
As at March 31, 2016



* Simulation of past returns as if the fund had been in effect for these periods

[1] These returns are on a net basis, for the Classic Series 75/75 of the IAG SRP.

Growth of $10,000
Since inception

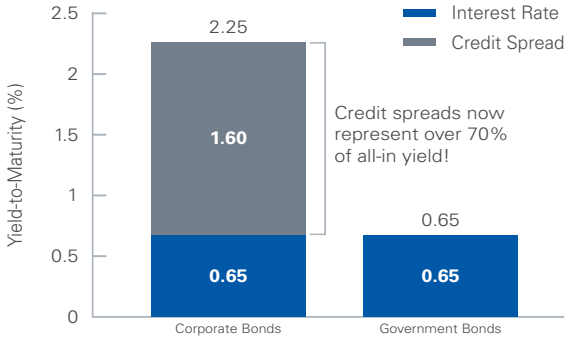


Simulation of past returns as if the fund had been in effect for these periods

iAIM snapshot
— Founded in 2004
— Assets under management: close to $79 billion
— More than 130 employees, including 75 investment professionals
— Firm emphasis on fundamental analysis and long-term investment

Attractive yields

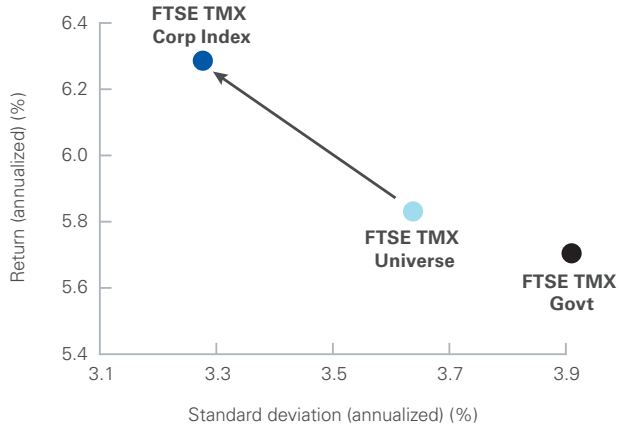
Yield-to-maturity:
Corporate vs government bonds (5-year term)



Source: RBC Capital Markets, April 2016

An excellent risk/return profile

FTSE TMX Canada: Universe Bond vs Corp. vs Govt
Return and standard deviation over 15 years ending Dec. 2015



Sector allocation
As at March 31, 2016

Sector	Canadian Corporate Bond Fund (%)	FTSE TMX Canada Corporate (%)	Deviation (%)
Energy	10	16	(6)
Financials	46	43	3
Industrials	5	7	(2)
Infrastructure	14	16	(2)
Real Estate	4	6	(2)
Telecommunication Services	13	10	3
Securization	1	2	(1)
Cash & Other	7	0	7

/ Featured Funds

Available starting May 16

Global Diversified (Forstrong)

Offered in: IAG SRP (Classic Series 75/75 & Prestige, Series 75/100 & Prestige), My Education+ & Prestige preferential pricing, and Ecofl*extra* Classic Series 75/75

Portfolio manager

Forstrong Global Asset Management Inc.

CIFSC Fund Category

(Canadian Investment Funds Standards Committee)

Global Equity Balanced

Lead portfolio manager

Tyler Mordy, CFA

- President and CIO for Forstrong Global
- Tyler is a recognized innovator in the design and application of "global macro" ETF portfolios
- Recently, ETF.com profiled Tyler as one of the "best and brightest" working in the ETF strategist industry
- Joined Forstrong Global in 2003
- Mathematics and English Literature (University of British Columbia)

Why consider this fund?

— Access growth opportunities from around the globe

— Focused on delivering capital growth over the long-term by investing in a diversified mix of assets through exchange traded funds (ETFs), with a fully global emphasis

— Manage "income risk" from a global perspective

— Tactically adjust asset allocation to capitalize on opportunities

Investment style & other characteristics

— Holdings: exposure to a maximum of 35 ETFs

— Forstrong Managed ETF Portfolios have the longest industry track-record of any separately managed balanced accounts exclusively implemented with ETFs

— Target allocation: 35% in fixed income securities, 65% in global equities

— Significant degree of leeway to move within investment limits (± 25% from target allocation)

— Strategically diversified across a broad range of asset types and sectors including global content — regions, countries and currencies

— Dynamic currency hedging strategy

Current Fund strategy

Over the past few quarters, investors have chosen to view global financial affairs cautiously. As it was, there was no shortage of factors serving to heighten fears. Indeed, global investment markets have recently been subject to heightened volatility and investor indecision.

Despite increased volatility, we are still forecasting long-term returns to be significantly above cash returns.

We remain of the view that the U.S. dollar is near its peak (versus the rest of the world's major currencies). The outlook for Canada remains negative as we anticipate commodity prices to remain in a low range for some time. Some selected investment shifts and themes that describe our current strategies are highlighted below.

Cash levels have been raised to neutral for core portfolios and modestly overweight in income mandates. Fixed-income allocations have been reduced to underweight. Ultra-low interest rates are simply not attractive, returning significantly less than equity market dividend yields.

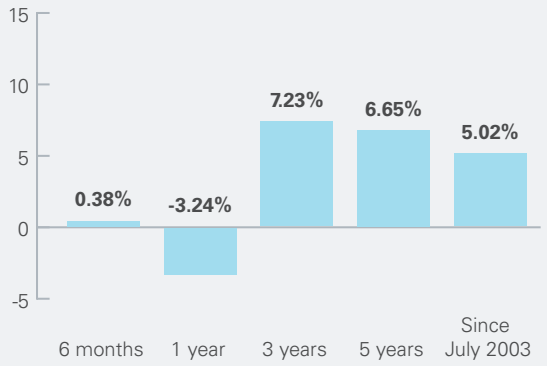
Equity exposure, therefore, has been raised modestly to a further overweight. Our asset mix nevertheless remains reasonably diversified, and therefore ideally suited for above-average market volatility.

While equity market exposure is overweight relative to our benchmarks, the equity allocation to the U.S. has been reduced to a further underweight. Exposures to Europe, Asia and selected emerging markets are overweight. Allocations to Canadian equities remain at a neutral level.

A major and enduring investment theme that we continue to emphasize is a "global income crisis." As such, we strive to achieve a higher portfolio yield than the benchmark. Our portfolios presently also emphasize selected emerging markets equities, India, emerging market local-currency bonds, higher growth countries, and high-yield investments within the "opportunities" component of the Global Diversified Fund.

Global Diversified (Forstrong)

Net compound returns[1]
As at March 31, 2016



* Simulation of past returns as if the fund had been in effect for these periods. The performance has been calculated by averaging the reported monthly returns of Forstrong's Global Balanced Focus and Global Growth Focus mandates.

[1] These returns are on a net basis, for the Classic Series 75/75 of the IAG SRP.

Growth of $10,000
Since inception

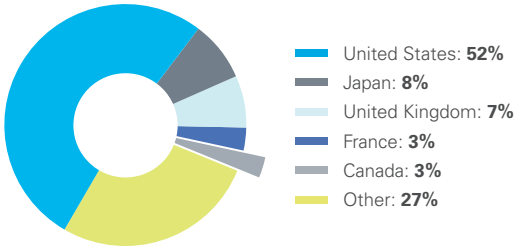
Simulation of past returns as if the fund had been in effect for these periods

Forstrong snapshot

- Founded 2001 to provide institutional quality global asset allocation strategies
- Global macroeconomic investment manager
- Longest track record managing global ETF portfolios
- Institutional process – documented, disciplined, proven

Investor need to look beyond Canada
Canada represents just 3% of world market capitalization*

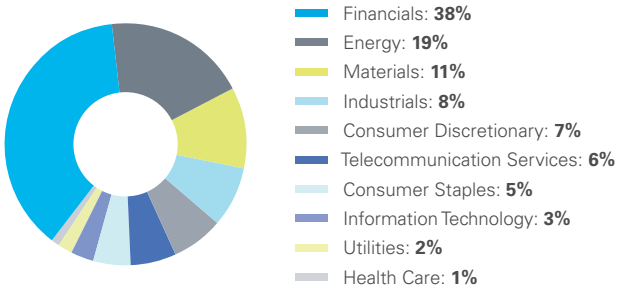
World market capitalization



*Source: MSCI All Country World Index

Canadian Equities → lack depth
In the S&P/TSX Composite, the top 3 sectors (Financials, Energy and Materials), represent approx. 2/3 of the index*

Sector breakdown – Canada



*Source: S&P/TSX Composite Index

Asset mix
As at March 31. 2016

	Minimum (%)	Neutral Weight (%)	Maximum (%)	Actual Weight (%)
Money Market	-	2.5	25.0	2.5
Canadian Bonds	-	0.3	-	0.4
Foreign Bonds	-	32.2	-	28.8
Total - Fixed Income	10.0	35.0	60.0	31.7
Canadian Equities	-	1.9	-	1.4
U.S. Equities	-	34.4	-	25.2
International Equities	-	23.1	-	26.1
Emerging Markets	-	5.6	-	14.4
Total - Foreign Equities	40.0	65.0	90.0	67.1
Alternative assets	-	-	-	1.2
Total - Portfolio	**-**	**100.0**	**-**	**100.0**

/ Featured Funds

Available starting May 16

U.S. Equity – Currency Neutral

Offered in: IAG SRP (Classic Series 75/75 & Prestige, Series 75/100 & Prestige), My Education+ & Prestige preferential pricing, and Ecofl*extra* Classic Series 75/75

Portfolio manager

Industrial Alliance Investment Management Inc. (iAIM)

CIFSC Fund Category

(Canadian Investment Funds Standards Committee)

U.S. Equity

Lead portfolio manager

Pierre Trottier, MBA, CFA

- Manages over $1.5 billion in assets
- MBA – (Laval University, University of South Florida)
- Bachelor's degree in actuarial science (Laval University)
- Degree in economics (Laval University)
- Joined iAIM in 2006 and holds more than 20 years investment experience

Why consider this fund?

— This Fund is a fully hedged version of the existing U.S. Equity Fund also managed by Pierre Trottier

— Appropriate for investors who wish to gain U.S. equity exposure while eliminating exposure to currency fluctuations between the US dollar and the Canadian dollar

— Long-term investment focus typically provides low turnover and tax efficiency

— Not subject to benchmark constraints and will not hesitate to deviate from the index in terms of sector allocation

— An excellent complement to a well diversified portfolio as the U.S. economy is the world's largest and most diversified

Investment style & other characteristics

— Blend (growth & value)

— Fundamental, bottom-up investment process

— Prefers companies that pay a dividend, but is not dogmatic on dividend yield

— Favours companies that have strong balance sheet earnings, earnings growth, and excellent corporate discipline

— Well-diversified portfolio (55 to 80 securities)

— The Fund may employ a covered call strategy to enhance income and decrease volatility

Current Fund strategy

The Fund's objective is to invest in the U.S. market while minimizing exposure to U.S.-Canadian dollar exchange rate fluctuations (through OTC contracts).

We are biased toward consumer sectors (consumer discretionary and consumer staples), which are likely to offer attractive dividend yields, present opportunities for consolidation and are well positioned to benefit from low energy prices. The recent drop in the U.S. dollar should also benefit multinationals.

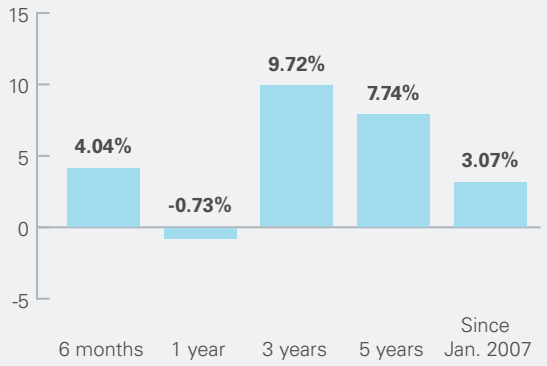
We remain cautious on sectors with high dividend yields, such as utilities and telecommunications. These sectors tend to underperform the market in an environment with the potential for rising interest rates.

We are biased toward the U.S. banking sector. We believe that the sector is currently undervalued and that it should benefit from future rate increases, the stabilization of oil prices and healthy growth of the U.S. economy.

Our main strategy is based on five major themes. First we are counting on the recovery of the U.S. real estate market by investing in companies like Home Depot, Lowes and D.R. Horton. We are also confident in U.S. consumers and their tendency to pay more and more with their cards (Visa, MasterCard). As well, we are expecting growth in e-commerce, which would benefit both transport companies and payment service providers. We are also biased toward pharmaceuticals, given the aging U.S. population as well as healthcare reforms. Finally, we particularly like companies with a strong potential for increasing margins, such as Kraft and Mondelēz.

U.S. Equity – Currency Neutral

Net compound returns[1]
As at March 31, 2016



* Simulation of past returns as if the Fund had been in effect for these periods and fully hedged its US dollar exposure

[1] These returns are on a net basis, for the Classic Series 75/75 of the IAG SRP.

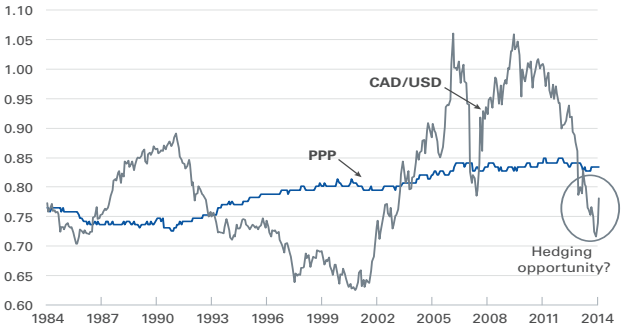
Growth of $10,000
Since inception

Simulation of past returns as if the fund had been in effect for these periods

iAIM snapshot

- Founded in 2004
- Assets under management: close to $79 billion
- More than 130 employees, including 75 investment professionals
- Strong emphasis on fundamental analysis and long-term investment

The loonie in an undervalued zone or now fairly valued?
$ CAD vs PPP (Purchase Power Parity)



Impact of currency on S&P 500 returns

	S&P 500 $USD (currency hedged) (%)	S&P 500 $CA (not currency hedged) (%)	Difference (%)
2008	(37.0)	(23.1)	(13.9)
2009	26.5	9.3	17.2
2010	15.1	9.0	6.0
2011	2.1	4.5	(2.4)
2012	16.0	13.5	2.5
2013	32.4	41.5	(9.1)
2014	13.7	24.0	(10.3)
2015	1.4	21.0	(19.6)
Q1–2016	1.4	(5.0)	6.4

Sector allocation
As at March 31, 2016

Sector	U.S. Equity – Currency Neutral Fund (%)	S&P 500 (%)	Deviation (%)
Energy	7.4	6.8	0.6
Materials	1.8	2.8	(1.0)
Industrials	8.4	10.1	(1.7)
Consumer Discretionary	11.2	12.9	(1.7)
Consumer Staples	18.8	10.4	8.4
Health Care	13.9	14.3	(0.4)
Financials	14.5	15.6	(1.1)
Information Technology	23.6	20.8	2.8
Telecommunication Services	-	2.8	(2.8)
Utilities	-	3.5	(3.5)
Cash & Other	0.4	-	0.4

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