iA Investment Watch

Economic and Market Overview and Featured Funds

For advisor use only

Quarterly / **June** / 2019

Economic and Market Overview

Clément Gignac

International

The hot topic for the last quarter was of course trade tensions between China and the United States. It would be useless to repeat the thread of events here, but the abrupt end of the negotiations and the belligerent (once again) tone of the American President have created a wave of shock on the financial markets.

At the time of writing[1], eyes are on Presidents Trump and Xi, who plan to meet on the sidelines of the G-20 summit in late June. The pressure is high because Trump still threatens to impose 25% tariffs on all imports from China, a measure that, if countered by equivalent retaliation, would have the potential to plunge the global economy into recession.

Europe

The European Central Bank (ECB), via its president Mario Draghi, surprised markets in June by saying that the Bank was ready to implement new monetary stimulus if inflation continues to slow. Mr Draghi did not offer more details, but the bond market soon incorporated the possibility of a cut in the key rate in July. We continue to believe that Europe faces significant growth challenges that monetary policy alone can not solve. The ECB insisted in June that governments will have to do their part and use their fiscal space to lift the European economy. The coming months will therefore probably be decisive for the European economy.

United States

US economic data continues to compare favorably internationally. GDP growth in the first quarter of the year exceeded 3.0% on an annualized basis and the second quarter looks positive, albeit with slightly lower growth, at 2.0%. The question everyone is asking is this: Will Mr. Trump really go through with his threats towards trading partners? An important fact to note is that no American president, with the exception of Calvin Coolidge in 1924, was able to be re-elected during a recession. If Trump and his advisers are looking to return for a second term in 2020, history suggests that they should be focusing on avoiding a recession rather than causing one.

Canada

The Canadian economy had an excellent second quarter in 2019, accumulating positive economic surprises. The Canadian economic surprises index published by Citigroup has been one of the most positive in the world in recent months. In the last 12 months (June 2018 to May 2019), nearly 425,000 jobs have been created across the country, averaging more than 35,000 per month. By way of comparison, the US economy has added about 50% fewer jobs per capita over the same period. The jobs created are mostly full-time and in the private sector, pushing the unemployment rate to an all-time low of 5.4%.

/ iA Strategy

Investors in the bond market are currently showing a high level of pessimism about the economic outlook. The implied probabilities of recession at the current level of interest rates exceed 60%, while our reading of the global economy suggests that the probabilities of recession are likely to be 25-30%. Faced with such a wide divergence of views, and taking into account the fact that recent surveys of major investors indicate that the most overbought market is that of US government bonds, we favor equities at the expense of bonds.

In June, global investors were showing the least optimistic regarding the outlook for the markets since 2009. In addition, the relative holding of equities versus bonds was the weakest in May since May 2009. In other words, the stock market is clearly shunned now, which suggests that a positive resolution of the main risk factors could lead to a mass return of investors on global stock markets. After healthy equity gains at the end of the first quarter, the return of volatility in recent months has given us the opportunity to gradually increase our equity exposure, favoring Canadian and international equities which offer us a more attractive valuation.

iA Financial Group

[1] The writing of this document was completed on June 28, 2019, a few hours before the expected meeting between Donald Trump and Xi Jinping on the margins of the G-20 Summit in Japan.

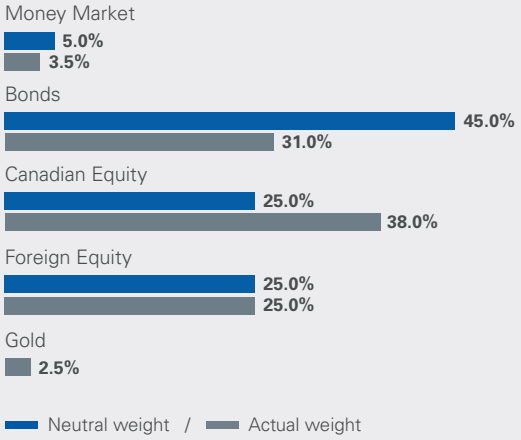
/ iA Managed Solutions

Diversified Funds

After temporarily reducing equity market risk in May as a result of escalating trade disputes between the United States and China, we gradually returned to the stock market in June. In addition, the majority of central banks have signaled their intention to maintain a rather accommodative monetary policy, which has the potential to stabilize economic activity in the medium term. As a result, we took advantage of market volatility to increase the weight of equities from 56.0% to 63.0% in the Diversified Fund during the quarter.

We also took advantage from the massive decline in interest rates to reduce our holdings of fixed income securities at the end of the quarter from 33.5% to 31.0%. Falling real rates across the globe and a weaker US dollar prompted us to increase our holdings of gold during the quarter (purchases of *Futures* contracts on gold bullion and an equity ETF of companies in the gold sector). These investments benefited the Diversified Funds' returns in June, with gold prices appreciating by almost 8%. Gold bullion exposure represented 2.5% of the fund at the end of June.

Finally, the strength of the Canadian data combined with high expectations of interest rate cuts in the United States led us to significantly increase our hedging position on the Canadian dollar (versus the US dollar) in order to benefit from an appreciation of the loonie.

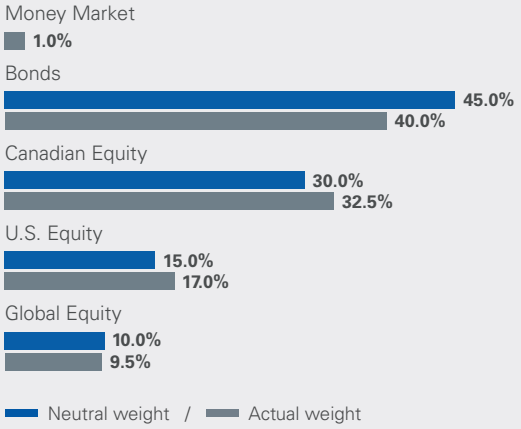


Selection Funds

Since Selection funds have a longer investment horizon, movements between asset classes were less pronounced during the quarter. After overweighting equities in the first four months of the year, Selection funds posted a neutral strategy during the month of May and the beginning of June. Increasing risks to the international trade situation and the synchronized slowdown in global economic data have made stock markets more volatile and weighed on interest rates. As a result, equities exposure was increased from 55.5% to 59.0% for the Balanced Selection Fund.

In return, the weight of fixed income securities fell from 43.5% to 40.0% for the Balanced Selection Fund. The fall of interest rates seems exaggerated to us and encourages us to underweight bonds.

Finally, the cash balance was maintained at 1.0% of the Balanced Selection Fund.



Focus Funds

This is a family of five funds, made up of various subfunds, 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). These funds are presented in this edition's Featured Funds.

/ Featured Funds

Fidelity Global Concentrated Equity

Offered in

IAG SRP (Classic Series 75/75, Series 75/100 and Prestige Series), My Education + (including Prestige Preferential Pricing), Ecofl*extra* (Classic Series 75/75)

Portfolio manager

Fidelity Investments

CIFSC Fund Category

Global Equity

Lead portfolio manager

Patrice Quirion, CFA

- Also manages Fidelity International Concentrated Equity Fund
- Joined Fidelity in 2005
- Master of Science in Finance, Queen's University
- Bachelor of Commerce with honours, HEC Montreal

Why consider this fund?

— Focused on companies with sustainable quality, predictable growth and attractive valuations

— Combination of a concentrated portfolio and broader investment constraints allowing the mandate to capitalize on securities with the highest conviction

— Emphasis on mitigating the likelihood of permanent losses of capital

Investment style & other characteristics

— Long term contrarian approach

— High concentration with approximately 50 holdings

— "Go anywhere" mandate with broad investment constraints

— "Quality at a Reasonable Price" investment style that targets predictable, durable and sustainable businesses

Current fund strategy

Portfolio manager Patrice Quirion believes that global markets are trending towards the later stages of the economic cycle. That said, there is a high degree of uncertainty about the time frame of the next global downturn. The general thinking is that trade wars and current signs of softening economic growth are already marking the beginning of the next recession. Patrice would note, however, that central bank monetary easing or a U.S.-China trade war resolution could have the potential to extend the current cycle by a few more years.

The uncertainty created by current conditions has resulted in a strong flight to safety taking place in the markets, and in some sectors, has led to a recession being partially priced in – as evidenced by the strong outperformance of defensive, quality, low-volatility and growth stocks relative to the universe of cyclical, out-of-favor and value stocks.

Patrice is generally a contrarian investor, trying to find opportunities where short-term negativity has led to valuations sufficiently low to provide attractive entry points for long-term positions in quality companies.

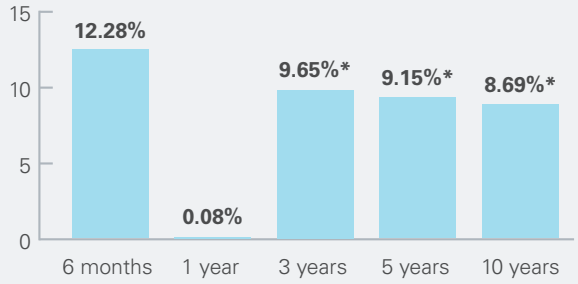
He currently sees better long-term opportunities in the parts of the market that have underperformed, notably value stocks and quality cyclical stocks. He believes that the risk/reward profiles for these companies are generally attractive, with strong performance expected either on a through-the-cycle basis or in the current cycle, should it be extended.

The portfolio manager prefers to invest in companies that have better potential to compound capital over the long term and where valuations are compelling. But given the nature of contrarian investing, the strategy can occasionally take time to play out, which can require patience from investors.

Fidelity Global Concentrated Equity

Net compound returns[1]

As at June 30, 2019



* 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

Classic Series 75/75 of the IAG SRP

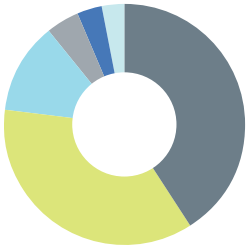
Simulation of past returns as if the Fund had been in effect for these periods

Fidelity Investments snapshot

- Founded in 1946: over 70 years of growth and innovation backed by a proven approach to investing
- Global investment network spanning North America, Europe, the Middle East, Africa and Asia-Pacific
- One of the world's largest providers of financial services
- Managed assets of more than US$2 trillion
- Over 750 investment professionals worldwide

Geographic Allocation

As at June 30, 2019



- Europe: **41.0%**
- United States: **36.2%**
- Asia and Pacific: **12.2%**
- Canada: **4.3%**
- Latin America: **3.5%**
- Other countries: **2.9%**

Sector Allocation*

As at June 30, 2019

Sector	Fidelity Global Concentrated Equity Fund (%)	MSCI ACWI Index (%)	Deviation (%)
Industrials	31.6	10.5	21.1
Consumer Discretionary	21.9	10.8	11.1
Health Care	15.6	11.3	4.3
Materials	4.4	4.8	-0.5
Real Estate	0.0	3.2	-3.2
Utilities	0.0	3.2	-3.2
Energy	2.0	6.1	-4.0
Financials	12.0	16.9	-4.9
Telecommunication Services	3.9	8.9	-5.0
Consumer Staples	1.5	8.3	-6.8
Information Technology	7.1	15.9	-8.8

*Cash not included

Top Ten Holdings

As at June 30, 2019

Frontdoor	
ARAMARK Holdings Corp.	
Brenntag AG	
Ferrovial SA	
Colfax	
NOF Corp.	
Meggitt PLC	
Bridgestone Corp.	
Jacobs Engineering Group Inc.	
Vipshop Holdings Ltd. ADR	
TOTAL :	**24.6%**

/ Featured Funds

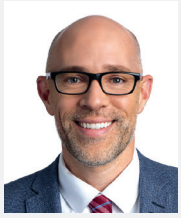
Fund names	CIFSC fund category
Focus Prudent	Global Fixed Income Balanced
Focus Moderate	Global Neutral Balanced
Focus Balanced	Global Neutral Balanced
Focus Growth	Global Equity Balanced
Focus Aggressive	Global Equity Balanced

Offered in all products

Portfolio manager

Industrial Alliance Investment Management Inc. (iAIM)

Lead portfolio manager



Sébastien Mc Mahon, M. Sc. Econ, PRM, CFA

- Joined iAIM in 2013
- Holds full responsibility for the management of Focus funds
- More than 15 years of investment experience
- Doctoral studies in economics at Université Laval

iA Investment Management

Why consider this fund?

— A turnkey solution offering optimal diversification that does not require any intervention by the adviso

— Simple and predictable portfolios with fixed asset allocation and monthly rebalancing which reflect the client's risk profile at all times

— Managed by an asset allocation expert who selects the underlying funds for their quality and complementarity, and who closely monitors these funds using state-of-the-art tools

Highlights of the Focus funds' redesign in June 2019

— To increase future expected returns, the equity weight was increased (+5%) and the fixed income holdings weight was decreased (-5%) for all profiles

— Foreign content has been increased for all profiles in order to offer a healthy diversification and to take advantage of investment opportunities on a global scale

— Fixed income holdings include Canadian government and corporate bonds as well as high-yield bonds, bank loans and foreign bonds

— New high-profile managers such as PIMCO, iA Clarington, Dynamic and Fidelity are added to iAIM within Focus funds

Current fund strategy

The Focus funds now have a slightly higher equity weighting (+5% for each risk profile), an improvement that should enhance future expected returns.

According to several polls published by major US banks, this past June, global investors posted their lowest optimism in stock market prospects since 2009. In June alone, cash holdings jumped to 5.6%, an increase in 1.0% over the month - the biggest increase for this time period since 2011. Furthermore, relative holdings in equities versus bonds were in May 2019 at their weakest level since May 2009. In other words, the stock market is clearly currently being avoided, which suggests that downside risks are limited and that a positive resolution of some risk factors could lead to a massive return of investors to global stock markets.

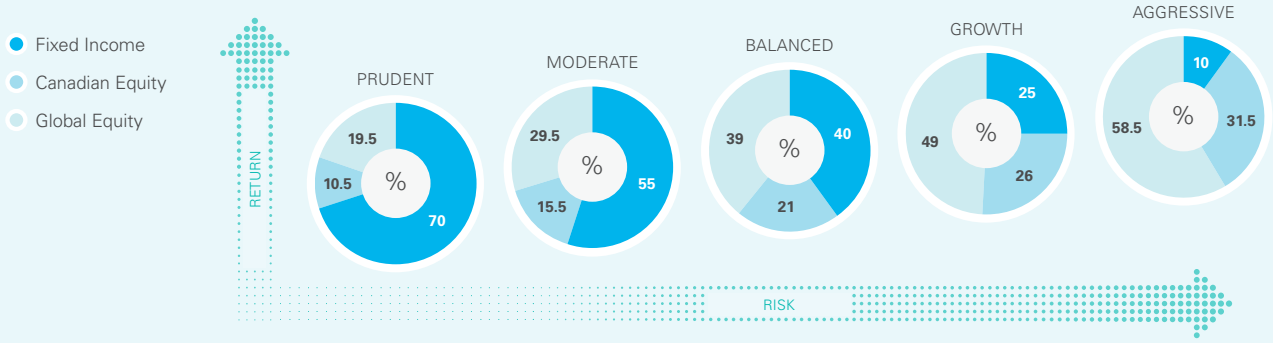
Thus, we believe that a slightly higher equity position will favor global investors.

As a matter of fact, the world's major central banks have paved the way for a good second half of the year on the stock markets.
In its June 19 decision, the Fed opened the door to an imminent cut in its key rate. Of the 17 members on the decision-making committee, 7 members perceived two rate cuts by the end of the year and 1 member predicted a single cut. Of the remaining 9 members, only 1 expects a further rate hike in 2019. This is a significant change in tone for the Fed, who was still talking about normalizing its monetary policy late 2018.

History shows that when the main risks perceived by the market slip away (here, a Fed that is sensitive to market concerns and the two major world powers working together), an overweight in equities is generally a winning strategy.

Focus Funds

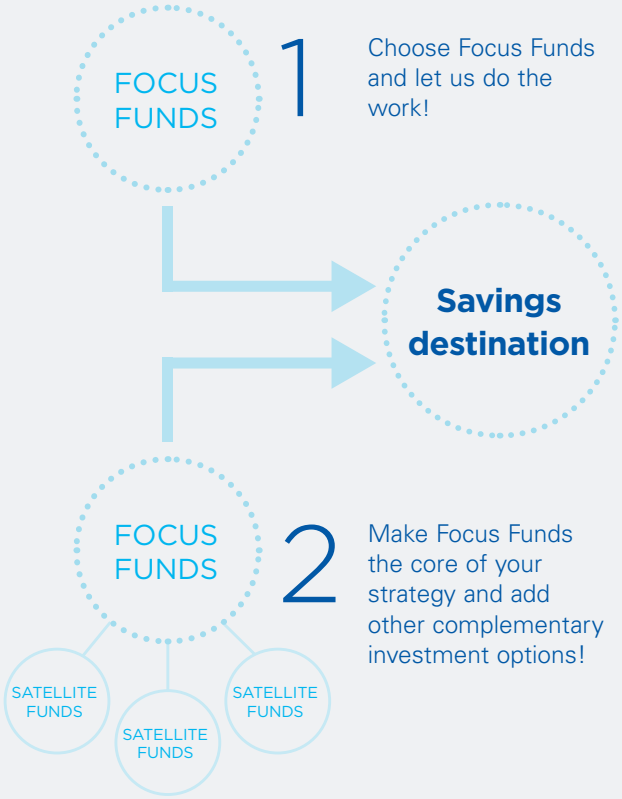
Target Allocations



Geographic mix

Canadian content:	65.5%	57.0%	49.0%	43.5%	38.5%
Global content:	34.5%	43.0%	51.0%	56.5%	61.5%

Focus Funds
One savings destination, two ways to get there!



Focus Balanced Target Allocations

Canadian Fixed Income	
Bond (iAIM)	28.0%
Global Fixed Income	
Global Fixed Income (PIMCO)	4.0%
Strategic Corporate Bond (IA Clarington)	4.0%
Floating Rate Income (IA Clarington)	4.0%
TOTAL – FIXED INCOME	**40.0%**
Large Cap Canadian Equity	
Canadian Equity Growth (iAIM)	10.5%
Dividend Growth (iAIM)	10.5%
Large Cap Global Equity	
Global Dividend (Dynamic)	13.8%
Fidelity Global Concentrated Equity	5.8%
International Equity	
International Equity (iAIM)	9.8%
U.S. Equity	
Thematic Innovation (iAIM)	2.5%
U.S. Dividend Growth (iAIM)	4.8%
U.S. Multi–Factor Equity (iAIM)	2.5%
TOTAL – EQUITY	**60.0%**

For an overall view of iAIM, see page 8.

/ Featured Funds

Canadian Corporate Bond

Offered in: IAG SRP (Classic Series 75/75, Series 75/100 and Prestige Series), My Education + (including Prestige Preferential Pricing), Ecofl*extra* (Classic Series 75/75)

Portfolio manager

Industrial Alliance Investment Management Inc. (iAIM)

CIFSC Fund Category

Canadian Fixed Income

Lead portfolio managers

Jean-Pierre D'Agnillo, CFA
- Lead Portfolio Manager
- 20 years of investment experience
- Bachelor's degree in business administration, Université du Québec à Montréal

Charles Barrette, MBA, CFA
- Senior Portfolio Manager
- Joined iAIM in 2008
- 15 years of investment experience
- MBA in finance, Université Laval
- Bachelor's degree in business administration, Université Laval

Why consider this fund?

— Attractive yields: Investment-grade corporate bonds (BBB- and above) offer a higher yield-to-maturity 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: Canadian corporate bonds have a historically low default rate

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

— Lower volatility: The asset class' shorter duration reduces volatility

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

Investment style and other characteristics

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

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

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

Current fund strategy

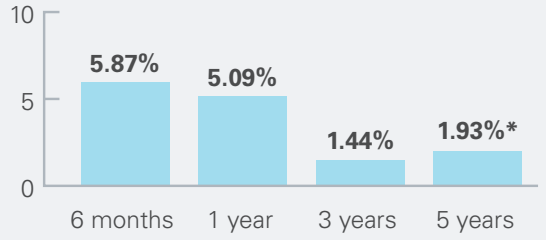
As credit markets continue to exhibit late-cycle signals, investor search for yield may continue to run with the potential easing from the US Federal Reserve and Central Banks globally. However, Q2 earnings reporting is just around the corner and lower guidance could dampen the positive accommodative tone from Central Banks. Falling yields in developed markets may be telling us something about investor risk appetite going forward. For credit investors, earnings and balance sheet protection by issuers will continue to be key, as rating agencies may be more pro-active this time around (compared to the pre-GFC period). Portfolio liquidity is also key and it will be a priority for us in this highly volatile environment when conditions can turn on a dime. In our view, trimming exposures to winning trades while keeping dry powder for periods of wider yield spreads will allow actively managed portfolios to outperform.

Over the next 3 to 6 months, our strategy will be to overweight higher beta sectors in the 5 to 10-yr part of the curve such as the Energy, Industrials and Telecom sectors, while emphasizing higher liquidity with an overweight in Banks. We still see the potential for tighter spreads and therefore corporate bonds should outperform government bonds. However, long-end deviations from the benchmark will be minimized due to the poorer liquidity and price volatility of longer-duration corporate bonds if risk markets hit a softer patch.

As deviations of the fund's risk exposure to interest rates and curve shifts are typically minimized, the fund will nevertheless be tilted slightly longer in relative duration for added protection if credit spreads widen.

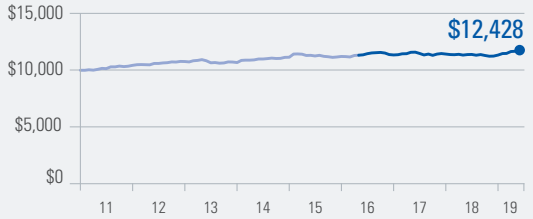
Canadian Corporate Bond

Net compound returns[1]
As at June 30, 2019



* Simulation of past returns as if the Fund had been in effect for these periods
[1] Returns on a net basis, for the Classic Series 75/75 of the IAG SRP

Growth of $10,000
Since inception



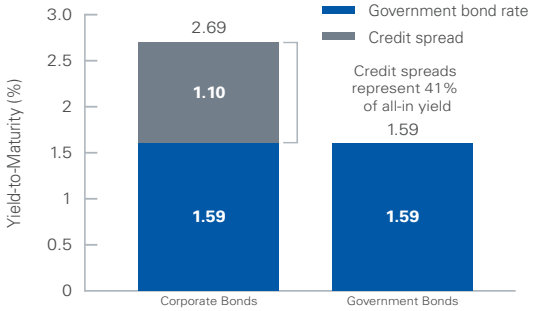
Classic Series 75/75 of the IAG SRP
Simulation of past returns as if the Fund had been in effect for these periods

iAIM snapshot

- Founded in 2004
- Major player in the asset management industry
- Manages $63.5 billion in general portfolios and segregated and mutual funds
- A team of 158 people, including 94 investment professionals (including 46 CFA charterholders)
- Composed of prudent managers who emphasize fundamental analysis, identification of value and long-term investing

Attractive yields

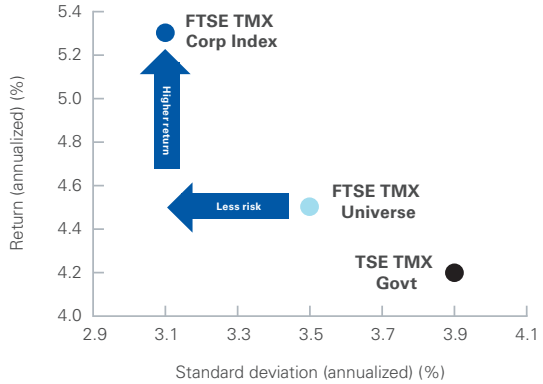
Yield-to-maturity
Corporate vs government bonds



Source: FTSE Russell, June 2019

An excellent risk/return profile

Universe Bond vs Corp. vs Govt
10 year period ending June 30, 2019



Sector allocation*
As at June 30, 2019

Sector	Canadian Corporate Bond (%)	FTSE TMX Canada Corporate (%)	Deviation (%)
Real Estate	6.8	0.0	6.8
Energy	21.8	19.4	2.4
Industrials	7.8	6.5	1.3
Financials	42.6	42.3	0.3
Telecommunication Services	8.4	8.3	0.1
Securitization	1.2	1.8	-0.6
Infrastructure	11.3	15.4	-4.1

* Cash not included

/ Useful links

Fund Performance

https://ia.ca/funds-performance

Economic News with Clément Gignac and His Team (ia.ca)

https://ia.ca/economic-publications/posts

Economic and Financial Publications (ia.ca)

https://ia.ca/individuals/individualsavings/publications-savings

IAG Savings and Retirement Plan (ia.ca)

https://ia.ca/iag-savings-and-retirement-plan

Prestige Preferential Pricing

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Morningstar

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