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Getting more active: The evolution of investing

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Over the past 35 years, investing in the broad equity markets has been profitable for many investors. The S&P 500 Index returned 12% on average per year for the 35 years ending May 31, 2017. Among the driving forces of this formidable rising tide were unprecedented monetary stimulus, persistent budget deficit spending, government deregulation of industries, expanding world trade, labour force growth and technological innovations. With the exception of technological innovation, the ability of these factors to drive the economy forward may decline as they either approach their natural limits or face political challenges. These structural shifts may lead to disappointments for passive investors who set their future return expectations by extrapolating their past experiences, even if they are looking back as far as 35 years. Meanwhile, active managers will likely need to get accustomed to being even more active in order to deliver strong results for their investors.

During the last 35 years, the active investment management industry has, for the most part, focused its resources on generating alpha – the return over and above the performance of the market – while putting far less emphasis on the management of an investor's exposure to the market itself. In the majority of multi-asset portfolios across the industry, the asset allocation decision was relegated to the category of risk management, where owning all asset classes was considered by many industry professionals as the wise solution. Despite academic studies suggesting that roughly 90% of the variation of a portfolio's total return is explained by asset allocation, a disproportionate amount of intellectual and financial capital was devoted to managing and marketing the 10% portion while effectively applying a passive "set it and forget it" approach to the much larger 90% portion. This does not exemplify active management to us and, more importantly, we believe that such a strategy will no longer work for investors. For several years, the Multi-Asset Management team has committed its resources to actively managing all the variables that affect an investor's total return, not just the alpha component.

While the debate between stock pickers and passive indexers rages on, each camp has robust absolute returns in their favour, thanks largely to the rising economic tide since the 1980's. Given the structural challenges ahead for the global economy, the need for actively managing the asset mix will become more critical in a low return world. To be successful, this must be done in a prudent fashion implemented through incremental adjustments and the use of a broad range of levers. The need for a more flexible asset allocation approach in conservative portfolios has been evident in recent years due to historically low bond yields. We are now approaching the point where further flexibility is needed across the entire spectrum of portfolios, including the most aggressive ones.

We expect that exchange-traded funds (ETFs) will play an increasingly larger role among professional and amateur investors. While they can increase risk if used improperly, passive and factor-based ETFs can be highly useful investment tools for active multi-asset portfolio managers when used within a robust framework. They can help to enhance precision in asset allocation and enhance responsiveness to market risk and opportunities.

ETFs are a form of industry automation that, when used appropriately, help active managers do their job better than they have in the past. We expect to utilize them to a greater extent in the future as we get even more active.

Combined top 15 equity holdings as of May 31, 2017 of the Evolution 40i60e Standard portfolio with Alpha-style exposure:

1. Microsoft	6. Alphabet Class C	11. Tourmaline Oil
2. Apple	7. UnitedHealth	12. Bank of Nova Scotia
3. Atco	8. E-L Financial	13. Suncor Energy
4. Canadian Natural Resources	9. Comcast	14. Franco-Nevada
5. Altagas	10. Chubb	15. Walgreens Boots Alliance