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Regime change

At Signature, we have been maximizing our underweight exposure to equities since the summer of 2014 and we have been defensively minded since the beginning of former Chairman Bernanke's taper in May 2013. This view changed in August. Now, three years and four months later, we are re-engaging risk. For the first time in this period, financial conditions in banks and credit markets are conducive to support growth in both emerging economies and developed economies.

The rebuilding of our equity weights highlights our positive view on markets and financial conditions going forward. Below I have laid out our framework on why we believe conditions are improving:

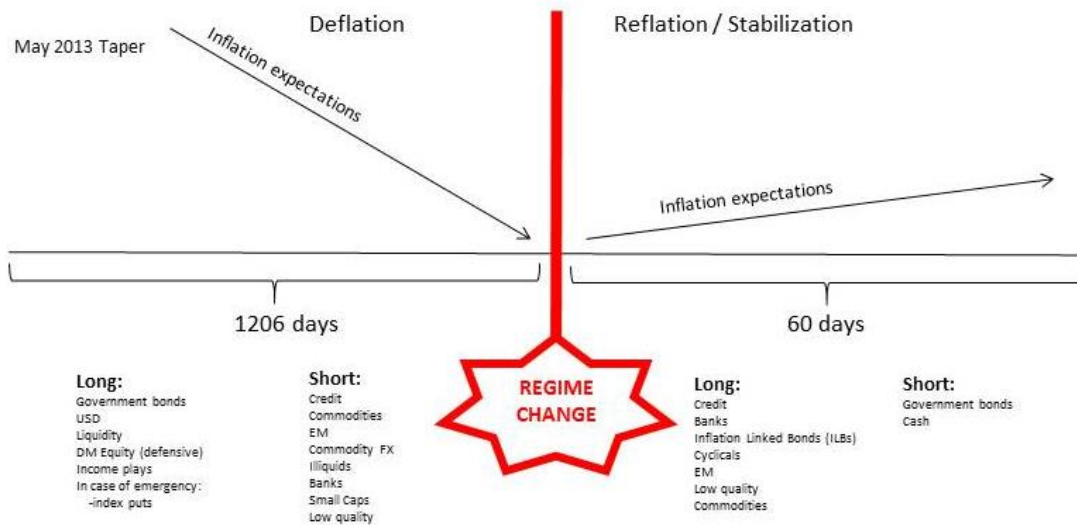
1. Financial conditions in credit markets spanning investment grade (IG), high yield (HY) and emerging markets (EM) are substantially repaired. The European Central Bank (ECB) and Bank of England (BoE), through purchases of corporate bonds (programs initiated this year), have reopened credit markets. Credit markets today are wide open. Financing costs are available to everybody with cheap rates.
2. The diminished central bank policy potency is being recognized and spurring future policy innovation (witness Jackson Hole). The Federal Reserve (Fed) has now acknowledged that they will not be able to raise rates materially. This has brought an end to the strong dollar chapter.
3. The points above support a mild recovery in EM growth as we expect sustained EM capital inflows and a revival of the equity deal activity post 2015/2016 deal famine. Refinancing of debts in emerging economies and of levered entities in developed markets omit (which) de-risks equity markets. This underpins a gradual stabilization of the resource sector.
4. All of the points above support a bottoming of the two-year earnings recession and a resumption of upper single digit earnings per share (EPS) growth is likely.
5. Positioning for risk remains light given macro concerns and a multi-year EM exodus.
6. Merger activity will accelerate with large volumes of cash deals given low financing costs. A low growth backdrop leaves few alternatives for value creation by CEOs. As well, share prices are at a level where selling boards feel satisfied.



7. Equity risk premium is elevated despite new highs on indices. Equity risk premium compression provides valuation support.
8. China – (i) equity crash and regulatory snafus of 2015 and (ii) currency devaluation versus neighbours – have been absorbed and are behind us.

Given this positive change, we have created a visual of our historical asset preference and what assets work in today’s environment given our re-engagement of risk outlook.

Regime Change Asset Mix



The rebuilding of our equity weights highlights our team’s view that a regime change is underway in markets. Fundamental macro forces are changing in relation to economic growth trends, currency, credit and interest



rate trends and as a result, portfolio flow trends. We have shifted from a low-growth, deflationary structure with tightening monetary policy in the U.S. and a widespread preference for liquidity to an improved growth trajectory with mild inflation, easy policy and a preference for carry over a longer horizon – the desire for carry is overwhelming liquidity concerns.

It is premature to be conclusive, so we are watching for further signals of this change – starting with a recovery of emerging market equity capital market activity. The equity capital market and debt capital market activity that we see in September/October of this year will be the litmus test of receptivity for risk assets. We believe this will show a very healthy market appetite for credit as well as equity in both developed and emerging economies. We are also exiting a two-and-a-half year earnings recession in developed and developing markets. This is very positive for equity markets.

In summary, we believe markets are at an inflection point where the capital flight from EM (the taper tantrum) has finally reversed. This points to greater foreign exchange and rate stability in emerging countries. The cost of a funding collapse in developed markets, in the interim period, should now reach into EM and support investment and consumption recovery. Low energy prices, low staple food prices and low cost of capital provide a supportive backdrop for Asia in particular.

The S&P 500 Index has dropped almost three percent from a record set on August 15 as bond yields have begun to rise globally. The recent market reactions and sell offs due to higher rates are natural and reflect a combination of slightly stronger global growth expectations and the possibility of weaker central bank support for the bond market. Markets are debating the implications of these developments for stocks. Our view is that rates are still low, confidence and activity are recovering which will be favorable for stocks.

At Signature, we pride ourselves on managing multi-asset portfolios to enact true risk management and helping clients navigate financial markets. We are pleased so many clients have chosen to trust with us with their hard earned savings and will continue to monitor conditions and see how this unfolds.

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