STRATEGIC EXCHANGE

CASE FOR ALTERNATIVES

AN ELEVATOR PITCH

"Despite strong recent returns, the outlook for a portfolio invested solely in equities and fixed income is dimming. Success in the next decade will require alternative strategies to compensate for lower expected fixed income returns."

Interested? May I have your attention for three more minutes?

New Diversifiers

For decades fixed income has been an asset loved by investors for providing an important diversification role. However, in today's low interest rate environment with an expected long-term return of approximately 2% for a universe bond index, the problem is not the past, but the outlook for the future.

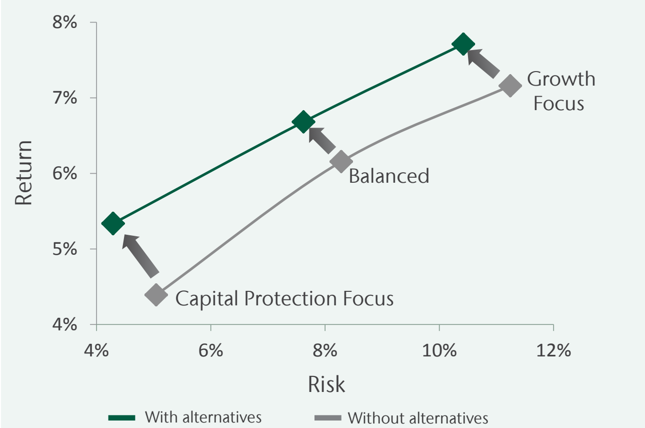
One solution could be to consider a higher exposure to equities to improve returns, but investors have become increasingly sensitive to the higher volatility when seeking greater returns through equities.

The Alternative Advantage

Going forward there will be an increasingly important role for alternative assets, such as real estate, infrastructure and absolute return strategies. Alternatives complement traditional assets and may improve expected returns given the nature of the asset and how its returns are achieved.

Chart 1 displays an efficient frontier plotting the range of risk and return points for different portfolio profiles - ranging from a capital protection focused portfolio to a growth focused portfolio.

Chart 1 – Efficient Frontier[1]



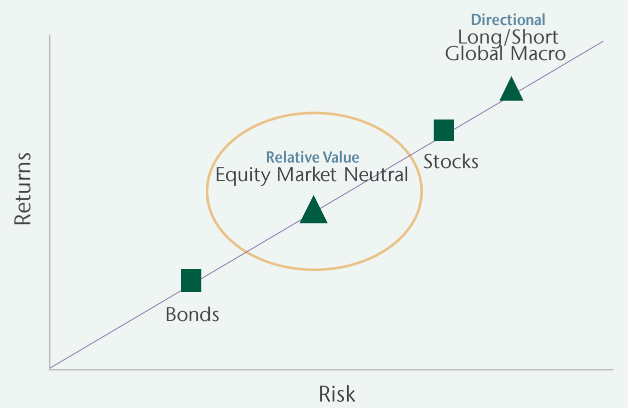
Source: Connor, Clark & Lunn Financial Group

Introducing alternatives increases the return while reducing the risk as a result of the complementary characteristics of real estate, infrastructure and absolute return funds to traditional asset classes.

The balanced fund with alternatives is expected to achieve a similar return to the growth focused portfolio without alternatives, but with two-thirds the volatility.

Real estate and infrastructure are relatively simple strategies to explain. However, the same cannot be said for absolute return funds, since there is a wide range of different strategies and risk and return profiles. As noted in Chart 2, not all absolute/hedge funds are created equal.

Chart 2 – Hedge Fund Risk Spectrum



Source: Connor, Clark & Lunn Financial Group.

While hedge funds are not as easy to understand, they have the ability to target positive performance regardless of the direction equity or fixed income markets may take.

They are investments well suited to the current environment, where high equity valuations are a challenge following a strong market run. And fixed income return generation is limited in this low interest rate environment.

The efficiency that hedge funds can capture is demonstrated in Chart 3, where there's an ability to increase the return with similar risk to equities, or to sacrifice some of the added value to reduce the risk.

Chart 3 – Hedge Fund Risk/Return Profiles[2]

Source: Connor, Clark & Lunn Financial Group.

Going Up

The investment outlook suggests that while the experience of the recent past has been beneficial for an asset strategy invested in equities and fixed income, future success will require greater diversification to compensate for lower expected fixed income returns. The complementary characteristics of alternative investments, such as real estate, infrastructure and absolute return funds suggest it may not be just the elevator going up.

1. Return and volatility are based on 10 year forecasts for the various asset classes within the model portfolios. Portfolios with alternatives includes an allocation of 5% Real Estate, 5% Infrastructure and Absolute Return Multi-Strategy. Multi-strategy allocation is 18% for the Capital Preservation portfolio, is 9% for Balanced and 14% for Growth Focus. **2.** Unless stated otherwise, all data is as at December 31, 2015 and stated in Canadian dollars (CDN$). Annual performance figures are as at December 31 for each calendar year. Source: Connor, Clark & Lunn Financial Group Ltd., Thomson Reuters Datastream. Performance history is that of the CC&L All Strategies Composite. The Composite has an inception and creation date of October 2007. Performance history is that of the CC&L Multi-Strategy Composite which has an inception and creation date of September 2005.All performance data is gross of fees unless otherwise stated. Gross performance figures are stated after transaction and operating expenses and before management and performance fees. For further information on performance, please contact us at more_info@cclgroup.com

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