Focused on quality and long-term dividend growth potential in U.S. markets

What's the strategy?

The U.S. Dividend (GWLIM) portfolio strategy invests mainly in U.S. stocks with attractive dividend yields and strong potential dividend growth along with the ability to achieve long-term capital appreciation.

What's the approach?

It blends top-down macro-analysis with bottom-up fundamental and quantitative stock research. The portfolio manager seeks to identify industry risks, competitive opportunities and macro trends to influence sector allocations. This is done alongside disciplined fundamental research and quantitative analysis to identify companies that are positioned to deliver strong results in the current market cycle.

Why invest in this portfolio strategy?

Ideal for investors seeking exposure to U.S. equities with a bias towards dividend-paying and dividend-growing stocks – a grouping that typically outperforms non-dividend-paying stocks over the long-term.

This portfolio is well diversified across sectors and income-focused. It offers a portfolio of dividend-paying stocks with a focus on positive return generation in up markets and capital preservation in down markets.

Typical portfolio characteristics

Here is what you can expect to see from the GWLIM U.S. dividend equity strategy when compared to its peers, or its U.S. benchmark, the S&P 500 index:

- Good diversification through exposure to at least 8 of the 11 sectors and an average of 50-100 holdings
- A higher dividend yield
- Historically had a lower volatility
- An attractive price per earnings (e.g. valuation measure)

This is a diversified U.S. equity portfolio that tends to have an attractive risk/return profile versus most U.S. equity strategies

Strategy snapshot

Asset class
Equity

Inception date
2013

Assets in mandate
$955.3 million

Benchmark
S&P 500 Index

Investment team
GWL Investment Management

Portfolio manager(s)
Clayton Bittner,
Vice-President, Equities

About GLC

GLC Asset Management Group Ltd. (GLC) is a leading investment management firm that manages more than $50 billion in assets.

GLC has 5 investment management divisions:

- GWL Investment Management
- London Capital Management
- Laketon Investment Management
- Portico Investment Management
- Portfolio Solutions Group

Each division has a distinct investment approach that offers deep expertise within specialized areas of portfolio management, bringing unique perspectives to navigating capital markets through varying cycles.

As at December 31, 2018

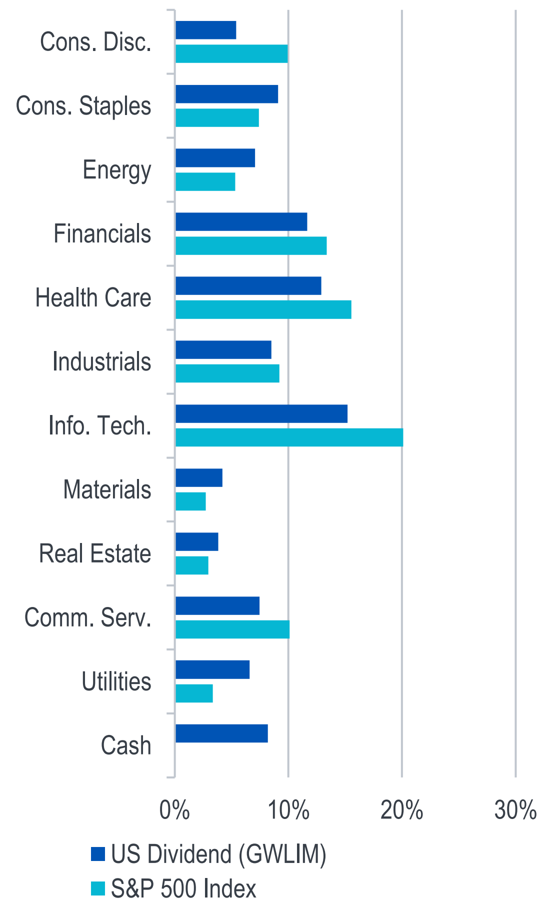
Portfolio attributes

Key attributes	Portfolio[1]	Index[2]
Market Cap.	138.2	201.2
P/E Curr. Yr. Median	14.6	15.4
P/B Curr. Yr.	2.3	4.8
Div. Yield	3.1	2.2
ROE Trail. 12	20.0	25.1
# of Equity Holdings	68	505

Major equity holdings %

Security	Sector	Portfolio Weight[1]
JPMorgan Chase & Co	Financials	4.8
Verizon Communication Inc	Communication Services	4.2
Chevron Corp.	Energy	3.6
Microsoft Corp	Information Technology	3.0
Pfizer Inc.	Health Care	2.2
Cisco Systems Inc.	Information Technology	2.1
Broadcom Inc.	Information Technology	2.1
Abbott Laboratories	Health Care	2.0
Southern Co.	Utilities	2.0
Union Pacific Corp.	Industrials	1.9
Total		**27.9**

Sector Allocation %



Source: GLC, CPMS, S&P | 1. Fund: LL U.S. Dividend Fund (GWLIM) | 2. Index: S&P 500 Index

Portfolio manager's quarterly commentary

As at December 31, 2018

Market review

Concerns of slowing global growth and continued trade tensions between the U.S. and China resulted in a sharp selloff for global equities during the quarter. The S&P 500 narrowly averted entering 'bear market' territory in December, with a peak-to-trough decline of 19.78%. The index finished the quarter down 13% in U.S. dollar terms (-8.2% in Canadian dollar returns, total return), the worst quarterly return since 2011, and pushed the index into the red for 2018. In December, the U.S. Federal Reserve hiked interest rates for the fourth time in 2018, which acted as additional headwind for equity valuations. Bond yields generally moved lower, and the defensive Utilities sector was the only one to post a positive return, up 0.5% for the quarter (price return). Information Technology was the biggest detractor, showing signs of weakness following a sustained period of outperformance. The five FAANG stocks (Facebook, Amazon, Apple, Netflix and Google) experienced drawdowns on average of 36%. The tech-heavy Nasdaq Index entered 'bear market' territory in

December. Energy was the worst performing sector, weighed down by a collapse in oil prices during the quarter (U.S. WTI oil prices were down 38%). From a style perspective, value outperformed growth.

Portfolio performance

The fund notably outperformed the broad-based S&P 500 index on a gross return basis for the quarter and comfortably outperformed its benchmark for the year. Performance was driven by a balanced contribution from both good stock selection and sector allocation. With the substantial market weakness in Q4, our defensive sector allocation and healthy cash position helped the fund performance. In addition, our positive selection contribution reflected continued improvement in value versus growth stock performance.

Portfolio activity

We reduced exposure to cyclical sectors early in the quarter and increased exposure to defensive sectors, however sector weights is a reflection of late quarter market movements more than specific stock actions. We added to our Consumer Staples exposure through our Pepsi position and bought weakness in Philip Morris International and Altria. In Energy, we eliminated Andeavor and replaced it with Marathon Petroleum. We continued to build on our Kinder Morgan position, taking advantage of negative midstream sentiment to add stability to our Energy exposure. We reduced our position in Blackrock, and reallocated to Prudential, which has less direct equity market exposure and is considerably cheaper. We sold Gilead and Allergan and trimmed outsized gains in Pfizer after a strong run. In the Materials sector, we reduced our position in DowDupont in favor of Air Products, which is a typically more stable business in the chemicals sector and trades at a notable discount to peers. We eliminated International Paper and reallocated to Avery Dennison, as the packaging sector has been under pressure and we believe it is prudent to move up the quality chain. Finally, we added a position in Canadian fertilizer company Nutrien. The agriculture cycle is not correlated with most materials stocks, so this exposure provides a partial hedge against broader sector weakness.

Positioning & outlook

Heading into 2018, while valuations were elevated, there remained a very bullish investor psychology. What caught people off guard, as is almost always the case, was the rapid breakdown in market internals (psychology) as the year progressed – reaching a fever pitch into year end. Whether it was the latent effects of higher interest rates and inflation, shrinking Fed liquidity, or geopolitical disputes that caused the shift is debatable, but what is clear is that this is end of cycle behavior. So now what? Many stocks are off 20% or more with markets showing some of the worst performance in a decade. Are there opportunities? Absolutely; however, if we now assume that inflation has peaked and the Fed must pause its tightening, the composition of market drivers will likely change too. Key mistakes here could be buying deep cyclicals too early or buying defensives too late. Plus, while short term valuations may appear attractive, full-cycle valuations remain elevated. None of this is easy. This is why we prefer to have a long-term philosophy and a view that does not get swayed by increasingly violent short-term market gyrations. Our previous inclination was to add to defensive names on weakness and sell cyclical strength. While we still broadly ascribe to this view, the massive damage to the markets in Q4 has the potential to drive a sizeable rally on the slightest positive news. In the new year, tactical trading in cyclicals and continued profit taking in defensives may prove prudent.

Relative to the index we are overweight the Utilities, Real Estate, Consumer Staples, Energy and Materials sectors. We have a healthy position in cash, and we are underweight the Technology, Financials, Industrials, Communication Services, Consumer Discretionary and Health Care sectors. Note that with the recent sector composition changes, Communication Services now includes Facebook and Google (previously under Technology). Prior to this change, we would have been overweight the group.