Sun Life Granite Enhanced Income Fund

FUND REVIEW Q4 2018 | Opinions as of January 1, 2019

MANAGEMENT COMPANY
Sun Life Global Investments (Canada) Inc.

PORTFOLIO MANAGERS
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HIGHLIGHTS

- Sun Life Granite Enhanced Income Fund fell 4.4% in the fourth quarter
- Added exposure to emerging market equities
- Continued to overweight Japan, relative other international equities
- Hedged volatility to potentially reduce risk
- Increased weighting in Canadian bonds
- Added to underweight position in U.S. bonds
- Increased cash levels in the portfolio

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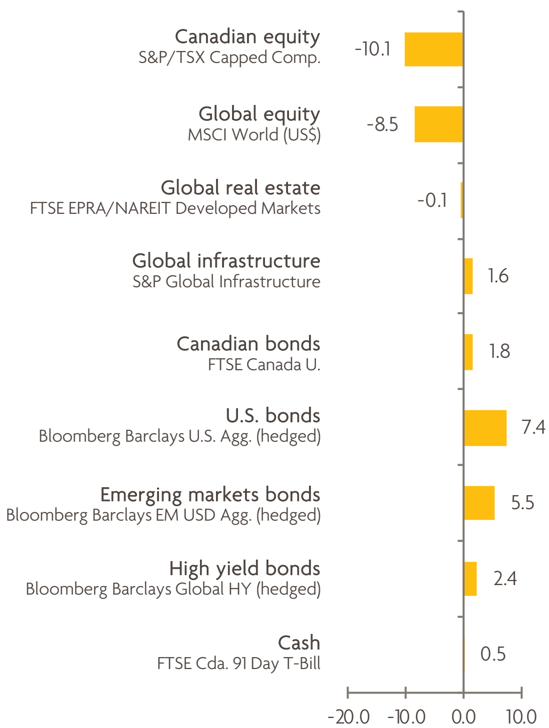
MARKET RETURNS



Source: Bloomberg. Data as of December 31, 2018.
Total return in C$ or as indicated.

OUTLOOK

Investors often find a year-end rally in their Christmas stocking. As we anticipated, this year there wasn't one, with key indexes plummeting worldwide as Q4 came to a close. In the end, the S&P 500 and the Dow Jones Industrial Average were down 4.4% and 3.9% respectively for the year – their biggest annual losses since 2008. Most of the losses came during an extremely volatile December, with the two key indexes posting their worst monthly performance since 1931.

Is the worst of the market rout now behind us? Given concerns over rising interest rates and the ongoing fallout from the U.S./China trade war, we expect volatility to continue. However, given the recent sell-off, we will look for opportunities to add to our equity weightings when appropriate.

The losses in U.S. markets were in sharp contrast to the country's prevailing economic fundamentals. In fact, despite Wall Street's woes, the Main Street economy continued to perform well. Consumer confidence is high, job growth remains strong and wages are rising.

Risks to the Canadian economy appeared to have been reduced with the signing of the new USMCA trade pact in September. But economic uncertainty returned with the collapse of oil prices in Q4, putting downward pressure on the Canadian market.

With the exception of Japan where economic fundamentals are improving, we are negative on international equities. However, we are overweight emerging market equities, which may show relative strength in 2019, after struggling in wake of the U.S./China trade war and as the U.S. dollar climbed in value.

Sun Life GLOBAL Investments

PORTFOLIO REVIEW

Sun Life Granite Enhanced Income Fund fell 4.4% in the fourth quarter.

Performance was hindered when volatility increased and major equity markets fell sharply worldwide.

Our overweight position in Canadian, U.S. and international equities weighed on the portfolio, with the S&P 500 down 4.4% and the MSCI EAFE Index correcting by 10.5% and the S&P TSX/Composite Index falling 8.8%.

The decision to underweight U.S. bonds also hindered performance when yields fell in the quarter, causing bonds prices to rise.

However, our overweight position in emerging market equities proved to be positive for the portfolios, with emerging market stocks performing well toward the end of the year.

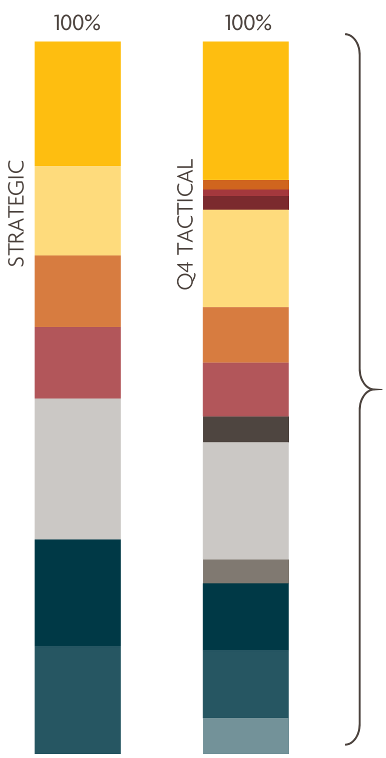
CONTRIBUTORS

- Overweight emerging market equities
- Overweight cash

DETRACTORS

- Overweight equities in general
- Underweight U.S. bonds
- Underweight infrastructure and real estate

Q4 ASSET ALLOCATION



ALLOCATION DETAILS AS OF DECEMBER 31, 2018

ASSET CLASS	STRATEGIC %	TACTICAL %	TACTICAL OVER/UNDER	TACTICAL CHANGE FROM PRIOR QUARTER
Canadian equity	17.5	19.6	2.1	-1.1
Canadian energy	Included in Canadian equity allocation above			
U.S. equity	0.0	1.3	1.3	-2.9
International equity	0.0	0.8	0.8	-1.1
Emerging markets equity	0.0	2.0	2.0	2.0
Global equity	12.5	13.6	1.1	1.1
Global real estate	10.0	7.7	-2.3	0.0
Global infrastructure	10.0	7.7	-2.3	0.0
Canadian bonds	0.0	3.5	3.5	2.5
U.S. bonds	20.0	16.4	-3.6	-1.8
Global bonds	0.0	3.3	3.3	0.0
Emerging markets bonds	15.0	9.5	-5.5	-0.5
High yield bonds	15.0	9.5	-5.5	-0.5
Cash	0.0	5.1	5.1	2.3
Totals: (May be rounded)	**100**	**100**	**2.7** Equity	

The coloured columns provide an at-a-glance comparison of long-term portfolio allocations (strategic) to current, short-term allocations (tactical). The table provides the weights for each asset class in each coloured column and shows to what degree the tactical allocation is a) different from the strategic allocation, and b) different from what it was at the end of the prior quarter. With this information you are able to see how the portfolio composition reflects our investment views, and how the composition evolves over time in accordance with an ever-changing market environment.

KEY TACTICAL CHANGES

- Initiated hedges on volatility to potentially reduce risk in the portfolios
- Moved to overweight position in emerging markets on relative valuations
- Reduced exposure to U.S. equities due to market pullback
- Maintained overweight to Japan on improving economic fundamentals and investment climate
- Underweighted U.S. bonds, overweighted Canadian bonds and adopted a duration-neutral strategy
- For defensive purposes, raised cash to potentially reduce risk.

Markets turned volatile in Q4 as worried investors headed to the sidelines in December's market rout. We believed volatility would increase, and took a number of steps to potentially lower risk in the portfolios.

This protective strategy involved initiating hedges in the latter months of the year on volatility, technology stocks, and emerging market equities. We also reduced equity exposure in specific areas.

Despite the selloff in U.S. equities, we believe the country's economic fundamentals remain solid. Still, concern over the pace of interest rate increases and the U.S./China trade war, helped push the U.S. market into a tailspin. As a result, we reduced our U.S. holdings but still remain overweight.

The oil price collapse added to market pessimism in Canada and we reduced our exposure, but remain overweight to Canadian equities. And given the lower valuations on Canadian equities, it may be a good place to be if markets correct further.

A number of issues continue to overhang the European economy. These include slower economic growth, Italy's fragile banking system, and a deteriorating political situation surrounding Britain's exit from the European Union. Consequently, we reduced our exposure but continue to hold a small overweight position.

The one exception in this category is Japan, where both the investment climate and domestic economy appear to be improving.

However, we added to our overweight in emerging markets. By our measure, equity valuations are now attractive and longer-term prospects for emerging markets remain potentially better than developed ones. And could also benefit if the U.S. dollar weakens.

In terms of fixed income, we remain overweight in Canadian bonds and underweighted in U.S. bonds. While yields fell in the quarter, we expect them to climb in 2019 as interest rates continue to rise, albeit at a slower pace than previously predicted.

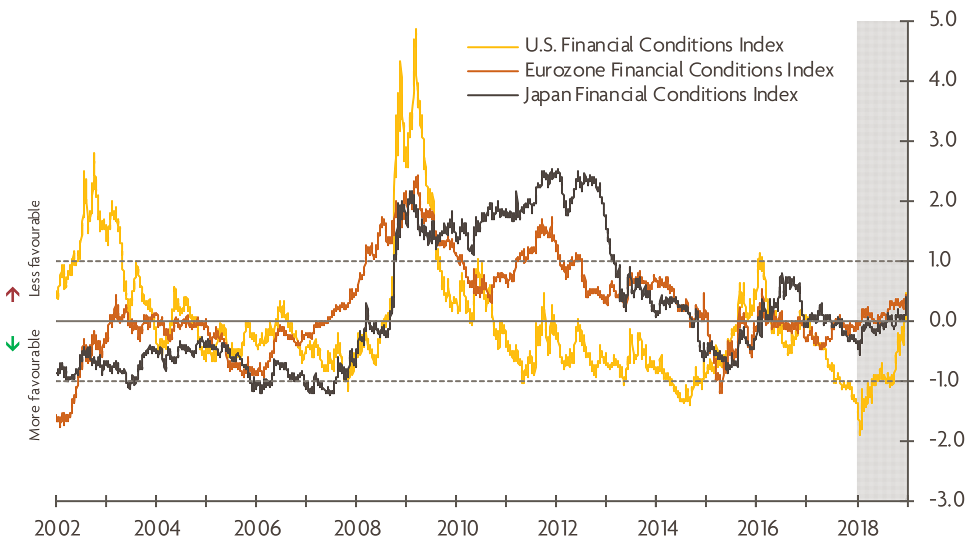
Given the uncertain interest rate outlook, we implemented a duration neutral strategy on a small part of the bond portfolio. This approach, potentially allows us to take advantage of increased volatility in the bond market. We may continue to use it in uncertain fixed income markets in the future.

FINANCIAL CONDITIONS SUGGEST WE'RE LATE IN THE ECONOMIC CYCLE

To take the pulse of the economy, Financial Conditions Indexes summarize different indicators, including short- and-long- term bond yields, credit spreads, currency values and equity prices.

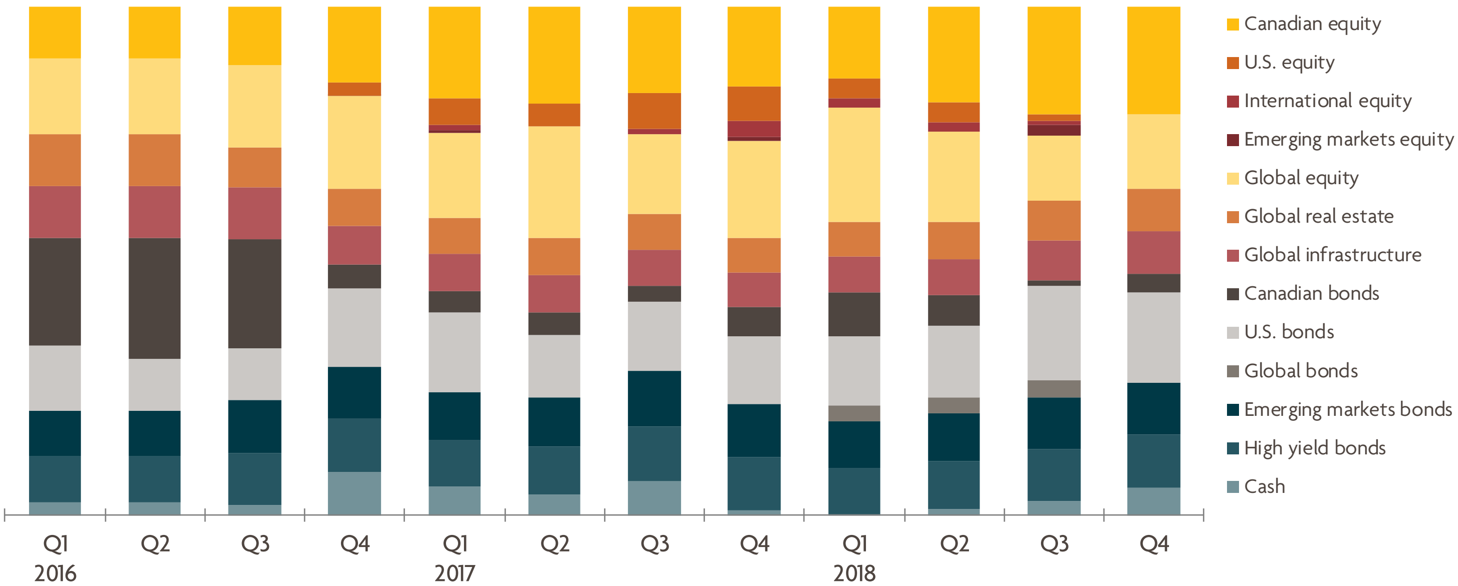
As shown here, following the 2008 financial crisis, looser financial conditions like rock-bottom interest rates gave people and corporations greater access to capital. This led to increased spending, which kept the economy well-oiled in what has been one of the longest periods of uninterrupted economic growth in history.

However, we appeared to reach an inflection point at the beginning of 2018 with financial conditions beginning to tighten again as interest rates climbed. This tightening may suggest that we are now in the final innings of a very long economic cycle.



Sources: Bloomberg; Goldman Sachs Financial Conditions Indexes. Data as of December 31, 2018.

TACTICAL ALLOCATIONS - HISTORY



Allocations are as at quarter-end and subject to change without notice.

FUND RETURNS %

	Q4	1 YR	2 YR	3YR	SINCE INCEPTION[1]	INCEPTION DATE
Sun Life Granite Enhanced Income Fund	-4.36	-3.63	2.33	4.02	5.65	January 16, 2013
Sun Life Granite Enhanced Income Benchmark[2]	-4.15	-3.50	1.58	4.70	5.22	

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Returns are rounded and are annualized for periods longer than one year. Data as at December 31, 2018. The returns provided are stated before investment management fees and include the reinvestment of all distributions. They do not take into account any administrative charges or taxes payable that would have reduced returns. Past performance may not be repeated.

[1] Since inception return for the benchmark is as of the fund's inception date.
[2] 20% BC U.S. Aggregate C$ Hedged, 15% BC Global High Yield C$ Hedged, 15% BC EMD USD Aggregate C$ Hedged, 10% FTSE EPRA/NAREIT Developed Index C$, 12.5% S&P/TSX Capped Composite Index, 5% S&P/TSX Capped Energy Index, 10% S&P Global Infrastructure Index C$, 12.5% MSCI World Index C$

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