SUN LIFE GRANITE MANAGED PORTFOLIOS

Tactical Update

MAY 2021 | Opinions as June 15, 2021

The views expressed in this tactical update apply broadly to all Sun Life Granite Managed Portfolios, whereas the tactical highlights and allocation data in the chart below are specific to Sun Life Granite Balanced Portfolio. For the latest information about other Sun Life Granite Managed Portfolios, including Sun Life Granite Managed Income Portfolios, please refer to our quarterly fund reviews published at sunlifeglobalinvestments.com.

The market strength we've seen this year, showed no signs of abating in May. Major economies continued to rebound, COVID-19 vaccinations accelerated, profit growth remained strong and the S&P 500 neared a record high. The question now is: how much of this positive news has been priced into the market? Certainly, valuations seem stretched and investor sentiment continues to run high. As a result, while still bullish overall, we are cautious and dialled back our equity overweight by 1.5% while increasing our cash position by an equal amount.

After rallying off the March bottom – one of the longest runs in history – most major equity indices are trading at or near record levels. For its part, the S&P 500 was up 11.9% for the year on May31, and the S&P TSX Composite Index was up 13.2%. At the same time, valuations have crept up and by some measures investor sentiment is higher than it has been in years. While we don't believe we are in an asset bubble, we took down our overweight exposure to U.S. equities by 1.8% in May to 1%. However, our weighting in Canadian, International and emerging market equities remained unchanged.

Overall, markets have been buoyed by the re-opening trade as the economy continues to normalize. While they lost a bit of steam in May, a number of asset classes tied to the reopening continued to move higher, including energy, financials, value stocks and cyclicals. In addition to being overweight value, we also continued to hold some high-quality growth names. And to potentially reduce risk, over the quarter we used option hedges tactically to provide downside protection, and others to earn premiums.

Our decision to reduce our U.S. weighting should not be interpreted as a negative call on the American economy. Indeed, the Conference Board forecasts that the U.S. economy will grow by 8.6% on an annualized basis in the second quarter of 2021. As well, monetary, and fiscal stimulus measures have flooded the U.S. economy with liquidity. As well, U.S. Federal Reserve Chairman Jerome Powell is holding to his statements that he will not raise interest rates until 2023. However, we believe the run up in U.S. equities is extended and we will look for opportunities to deploy our cash elsewhere.

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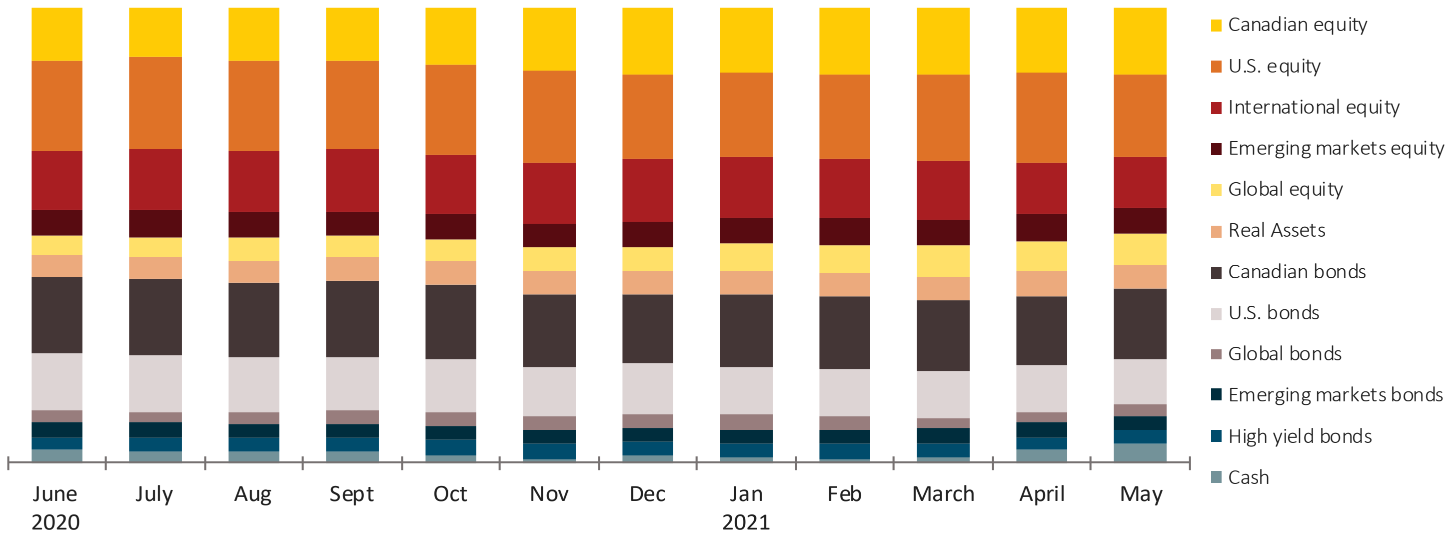
TACTICAL HIGHLIGHTS

CHANGE	RATIONALE
Reduced exposure to U.S. equities	Valuations appear extended
Underweight duration sensitive bonds	Interest rate risk
Overweight emerging markets	Expect select EM countries to do well

TACTICAL ALLOCATIONS | SUN LIFE GRANITE BALANCED PORTFOLIO



Allocations are as of month-end unless otherwise noted and subject to change without notice.

▸ *Continued from previous*

While we remained neutral, we are nonetheless positive on the Canadian economy, which has benefitted from the surging demand for commodities. This includes the price of oil which has doubled to almost US$70 a barrel over the last year. As well, if interest rates trend higher, as we suspect they will, it will help the Canadian financial sector.

As for the broader economy, despite the lockdowns, it has held up relatively well – helped by an improving unemployment picture and a continuing rise in house prices. In addition, Canada's vaccination effort (in terms of one dose) is now among the best in the G20. Ultimately, we believe that the S&P/TSX Composite Index, with its heavy weighting in financials, energy and materials could continue to benefit as the global economy emerges from the pandemic.

Emerging market equities are now our largest overweight position at 1.5%. We believe that the long-term upward trend in emerging markets will continue with many developing countries outperforming their developed counterparts.

However, there are headwinds, including from an uneven response to the COVID-19 pandemic. For example, 72% of people in developed markets are expected to be vaccinated by the end of the year. This compares to only 28% for those in emerging markets. That said, China, with the largest weighting in our benchmark, is primarily free of the virus and its economy has come back strongly. Other emerging market economies could follow in 2022, but until then we are being selective.

The European economy is improving, but at slower pace than the U.S., with growth expected to come in at 4.2% in 2021. A slower rollout of vaccines compared to the U.S., has led to longer lockdowns and has been a major factor in holding back the recovery. At 6% of GDP there has also been less fiscal support for the Eurozone economy, compared 14% in the U.S.

Still, there are signs that the European recovery is gaining ground. In fact, despite rising commodity prices and supply chain issues, European manufacturing (on rising export demand) has been robust in recent months. That strength was captured by IHS Markit's Eurozone Manufacturing Purchasing Managers' Index which climbed to 63.1 in May – one of its best performances since 1997. However, we continued to underweight international equities which comprise the smallest component of our equity weighting. But we will be looking for opportunities to invest in the coming months.

In terms of fixed income, the yield on benchmark U.S. 10-year Treasuries continued to distract investors in May. After hitting 1.74% in March, yields retreated to around 1.5%. Many investors believe yields will head higher again, hurting longer-dated maturities. But even as inflation indicators came in above the Fed's target range, the yield on 10-year Treasuries did not rise meaningfully. This, perhaps, suggests that the bond market is still waiting to see if another leg up in yields will occur. However, given the interest rate risk, we are underweight duration sensitive issues, including U.S. treasuries and Canadian bonds.

Sun Life Global Investments
1 York Street, Toronto, Ontario M5J 0B6
T: 1.877.344.1434 | E: info@sunlifeglobalinvestments.com
sunlifeglobalinvestments.com/Commentary