



### i-Watch Rating System:

**Date** 1/31/2020  
**Fund Manager** Guardian Capital  
**i-Watch Status** ● **Increased Scrutiny**

- No concern(s)
- Moderate concern(s) requiring frequent and close monitoring
- Serious concern(s) that require a full review and may lead to removal from the fund platform

### Product(s) Impacted:

Guardian International Equity Fund (GRS)  
Guardian Balanced Fund (GRS)  
Guardian GEM Balanced Fund (GRS)

### Notice

GMR has downgraded several Guardian Capital Funds which are managed or partially managed by their Foreign Equity Systematic Team to an Increased Scrutiny rating. The Guardian Systematic Team has enacted changes to their process and portfolio affecting both the investment model and portfolio construction that applies to their International, Global and U.S. growth equity strategies. The model change incorporates quantitative factors and data to make predictions for company's future earnings per share (EPS). The EPS prediction model seeks to predict the forward 1-year EPS growth rate as well as the probability that the actual EPS growth will decline significantly. Fund management will rely increasingly on a combination of the new model and human intelligence and less on quantitative optimization for portfolio construction, resulting in a significant reduction in the number of portfolio holdings.

### Impact

Guardian employs a systematic quantitative approach for its Global, International and U.S. equity funds. Guardian's approach had been a combination of relative and intrinsic models to attempt to compare and detect pockets of strength in global markets. The model adjustment attempts to leverage the exponential increase in types of data from individuals, business and machines, the adoption of big data and data science techniques. The objective is to apply an artificial intelligence (AI) classification algorithm to available data in order to generate more accurate earnings forecast for companies over the next year. This change has been largely incorporated into the existing intrinsic and relative value process resulting in a change in model weights from 80% Relative Value/20% Intrinsic Value to a 60% AI/30% Relative/10% Intrinsic. Fund management believes this new approach will allow for better pattern recognition and to better anticipate future events. As a result of this larger focus on sustainable earnings growth, Fund management believe the Funds will have higher earnings quality and less cyclical exposure.

There will be less usage of quantitative optimization for portfolio construction as Fund Management's decisions will be derived increasingly by a combination of the model and human intelligence. The investment team believes that the EPS model changes will provide

higher confidence around name selection. This increased conviction has led to a significant reduction in the number of portfolio holdings. The eliminated names were frequently smaller positions selected by the quantitative optimizer to maintain risk parameters. Fund management also determined that the timing effect of a quarterly rebalance was not effective in adding value. The changes to the number of portfolio holdings and portfolio construction will generate a more concentrated portfolio with a higher tracking error relative to the benchmark.

### **GMR Evaluation**

These Guardian Funds have been downgraded to Increased Scrutiny due to concerns regarding these substantial changes to both process and portfolio. Given the Guardian Systematic Team's research focus and quantitative background, attempting to utilize artificial intelligence to utilize large amounts of existing and new data sources to provide a competitive advantage for their alpha generation process is not out of line with expectations. While ongoing research and the inclusion of anticipated model improvements are expected, these changes are substantial and the resulting performance, risk and portfolio changes must be monitored closely to assess their long-term impact. GMR will communicate should any further concerns arise.



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