Market Commentary

Second Quarter 2015

CI Investment Consulting

Portfolio Series and Portfolio Select Series

Alfred Lam, Senior Vice-President and Portfolio Manager, CI Investment Consulting

Market performance

Stock and bond markets gave back some gains during the second quarter. Some analysts suggested this decline was due to the uncertainty surrounding the Greek debt situation and the timing of the first U.S. Federal Reserve rate hike. It also reminded investors that capital markets do not always produce positive returns in the short term. Market declines are normal; they help to reset expectations and create opportunities.

Returns in % at June 30, 2015	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr
S&P/TSX Composite Index	-1.6	0.9	-1.2	11.1	8.3	6.9
S&P 500 Index (C$)	-1.4	8.9	25.5	25.5	21.2	8.1
MSCI World Index (C$)	-1.2	10.7	19.1	22.9	17.5	7.2
FTSE TMX Canada Universe Bond Index	-1.7	2.4	6.3	3.8	5.1	5.0

Source: Bloomberg, FTSE/TMX

Portfolio Series and Portfolio Select Series

All Portfolio Series and Portfolio Select Series funds were positioned somewhat defensively after taking some profits during the first quarter. The bond portion was overweight corporate bonds to collect an interest premium and to achieve low duration to mitigate interest rate risk. As always, the equity portion was well diversified both globally and at the sector level. We expected the resource sector to remain under pressure as the global economy has been growing at a slow pace while supply is generally ample. As a result, our portfolios remained underweight both Canada and the resource sector.

These strategies helped to reduce volatility but some downside was unavoidable, as most markets and sectors other than cash incurred some losses during the second quarter. While the decline was broad based, the loss in general was modest and all of our portfolios posted attractive returns for the first six months of 2015.

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Returns in % at June 30, 2015	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr	Life
Portfolio Series Income Fund	-2.1	2.9	5.6	7.3	7.5	5.3	5.4 (Dec. 97)
Portfolio Series Conservative Fund	-2.0	3.7	6.8	8.9	8.0	5.0	5.4 (Dec. 97)
Portfolio Series Conservative Balanced Fund	-1.9	4.0	7.0	10.3	8.8	5.1	5.2 (Dec. 01)
Portfolio Series Balanced Fund	-1.8	4.5	7.9	11.4	9.3	5.3	7.1 (Nov. 88)
Portfolio Series Balanced Growth Fund	-1.4	5.1	7.7	12.6	10.0	5.2	5.1 (Dec. 01)
Portfolio Series Growth Fund	-1.2	5.4	7.9	14.0	10.8	5.2	4.8 (Dec. 01)
Portfolio Series Maximum Growth Fund	-1.2	6.2	8.8	16.1	11.9	5.2	4.4 (Dec. 01)
Select Income Managed Corporate Class	-1.4	2.2	4.1	4.8	n/a	n/a	4.4 (Sept. 10)
Select 80i20e Managed Portfolio	-1.3	2.8	4.9	6.9	6.3	n/a	4.2 (Nov. 06)
Select 70i30e Managed Portfolio	-1.3	3.1	5.2	8.0	7.0	n/a	4.2 (Nov. 06)
Select 60i40e Managed Portfolio	-1.2	3.3	5.6	9.1	7.7	n/a	4.1 (Nov. 06)
Select 50i50e Managed Portfolio	-1.2	3.7	5.9	10.2	8.5	n/a	4.2 (Nov. 06)
Select 40i60e Managed Portfolio	-1.2	4.0	6.5	11.4	9.3	n/a	4.2 (Nov. 06)
Select 30i70e Managed Portfolio	-1.1	4.3	6.8	12.5	10.0	n/a	4.1 (Nov. 06)
Select 20i80e Managed Portfolio	-1.1	4.7	7.3	13.7	10.8	n/a	4.2 (Nov. 06)
Select 100e Managed Portfolio	-1.1	5.2	8.0	16.0	12.2	n/a	4.0 (Nov. 06)

All fund returns are for Class A units/shares

Select Income Managed Corporate Class

Bond markets started the year strongly, benefiting from a surprise rate cut of 25 basis points in Canada and the expectation that the European Central Bank would pursue an aggressive quantitative easing program. The FTSE TMX Universe Bond Index gained a significant 4.6% in the month of January alone. However, bond prices peaked on February 2, when the yield on a 10-year government of Canada bond reached a low of 1.24%, representing a drop of 55 basis points from the beginning of the year. At the time, the market appeared to be forecasting that interest rates would remain low for a very long period of time and could in fact decline further, as bond investors were getting paid only a very small premium for lending over the long term.

From February to June, two major developments affected investors' expectations and caused the markets to re-price. Firstly, the Bank of Canada surprised the markets again – this time by not pursuing another rate cut. Secondly, the ECB claimed early improvements to the European economy, which effectively took the risk of deflation out of the picture. Bond yields climbed steadily as a result, most noticeably for German government bonds, where the 10-year yield rose from eight basis points to 99 basis points in a very short period of time. The Canadian market experienced fluctuations on a smaller scale. The Government of Canada 10-year yield peaked at 1.90%, which was enough to create volatility and negative results for bond investors. As of June 30, the domestic bond markets as represented by the FTSE TMX Universe Bond Index had incurred a loss of 2.2% since the end of January.

Select Income Managed Corporate Class was positioned with less interest rate sensitivity and enhanced diversification relative to the bond index during this period. Duration, which is a common measure of interest rate sensitivity, was significantly lower than the index (four years vs 7.4 years). The addition of asset classes such as foreign currencies, short duration corporate bonds, high-yield bonds and stocks helped to reduce the portfolio's correlation to the fixed-income markets. While these asset classes reduced portfolio volatility as intended, they did not make strong contributions to the portfolio's returns.

Market corrections typically create opportunities. We have not added to our Canadian bond holdings, as we believe the risk-return payoff is more attractive abroad. The sentiment on U.S. bonds has been quite negative for some time – it is beginning to form a buyers' market. However, the bond markets will likely remain volatile up until the first rate hike by the U.S. Federal Reserve, which is widely expected to be September. We anticipate that the Fed will be very cautious with every move so that it does not derail the economic recovery and consumer sentiment.

In recent months, we have been adding U.S. Treasury bonds to the portfolio. Overall, the portfolio is still underweight fixed income even with the recent purchases. In addition, we are holding 16% in cash, mostly in U.S. dollars. All things being equal, rising rates in the United States should attract foreign investments and provide a boost to the U.S. dollar. So, if rates do rise more aggressively than anticipated, our portfolio has some protection.

Bonds, by design, are suitable investments for investors who are risk averse and have a shorter investment time horizon. However, investors should be cautious that valuations may become too rich from time to time. Select Income Managed has the flexibility to hold cash and wait for opportunities to present themselves, as well as the ability to diversify investments with asset classes beyond government and investment-grade bonds. In the 57 months since the fund's inception in September 2010, we have had 44 positive months, compared to 36 for the FTSE TMX Universe Bond Index. This consistent result is a testament to our process and discipline in allocating assets to both preserve capital and grow investor account balances in a prudent manner.

Outlook and positioning

The Greek government and its creditors ended months of negotiations and reached an agreement on July 12. This agreement requires Greece to follow new austerity measures in exchange for aid to keep the country and the banking system solvent. We welcome the agreement although we did not expect the ongoing crisis to have an impact on the world economy or our portfolios. The Greek economy is relatively small and the ECB has the ability to contain any spillover effects to the overall European banking system and economy.

Despite the increased volatility in the markets, our general outlook has not changed. The global economy is improving but growth is still not robust. This explains the high unemployment rate in some countries, under-employment in most countries, and weak consumption overall. It is not all bad news; it may also mean that the recovery will be longer and interest rates will remain lower than normal for longer. This is generally a good backdrop for investing. However, market valuations also reflect that, with stock market valuations at fair levels. The best investment opportunities are often created during a crisis, when valuations are depressed, and financial markets are not in a crisis today.

As described above, we have added to our holdings of U.S. dollars and bonds. These asset classes in general have a negative correlation to equity markets during periods of stress. This means that by investing in these asset classes, our portfolios' downside volatility has been reduced.

The businesses we own are solid. Speculation is not in our DNA. The portfolios hold overweight positions in the United States, where the quality of companies in terms of stability of revenue streams, balance sheet strength and innovation is top notch. To own companies that do not have these solid attributes, we would require a substantial return premium and such opportunities are limited. We continue to carry high cash levels and are being patient. Earning an attractive return for our investors with less volatility than the market remains our goal.