Market Commentary

Third Quarter 2013

CI Investment Consulting

Portfolio Series and Portfolio Select Series

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Market performance

Despite the looming U.S. debt ceiling, stock markets globally finished the quarter with strong performance. The Canadian market, which has been out of favour for the last two years, gained steam as a result of higher oil prices and corporate acquisition activities. In the bond market, yields on the five-year and 10-year government of Canada bonds climbed to 2% and 3%, respectively. The domestic bond markets, as measured by the DEX Universe Bond Index, gained 0.5% in September to end the quarter with a modest gain.

U.S. Federal Reserve Chairman Ben Bernanke announced in September that the Fed would continue with its asset purchase program at the rate of US$85 billion a month. The markets had been expecting a modest cutback and now believe that a reduction in the program will not begin until December at the earliest. Subsequent to quarter-end, President Obama nominated Janet Yellen as the next Fed chair. It is widely expected that Yellen will continue Bernanke's dovish monetary policy. Meanwhile, German Chancellor Angela Merkel's party was re-elected, which was good news for investors who value stability.

Market Returns in % at September 30, 2013

	3 mth	YTD	1 yr	3 yr	5 yr	10 yr
S&P/TSX Composite Index	6.2	5.3	7.1	4.1	4.8	8.4
S&P 500 Index (C$)	3.1	24.3	25.0	16.3	9.3	4.7
MSCI World Index (C$)	6.0	22.2	26.6	12.5	7.8	5.3
DEX Universe Bond Index	0.1	-1.6	-1.3	3.5	5.6	5.2

Source: Bloomberg, PC Bond

Portfolio Series and Portfolio Select Series

Our portfolios benefited from our decisions to hold additional cash, underweight positions in government bonds, Canadian stocks and emerging market stocks, and overweight positions in U.S. equities and the U.S. dollar. In addition, stock selection by the individual portfolio management teams further enhanced our performance relative to the benchmarks. Even though the Canadian market has generally lagged its global counterparts, our Canadian equity fund managers have successfully navigated this environment with significantly better performance than the S&P/TSX Composite Index.

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Portfolio returns in % as of September 30, 2013

	3 mo	YTD	1 yr	3 yr	5 yr	10 yr	Life
Portfolio Series Income Fund	1.4	4.8	6.4	5.6	6.7	5.4	5.1 (Dec. 97)
Portfolio Series Balanced Fund	3.2	10.0	12.4	6.6	5.7	5.6	6.8 (Nov. 88)
Portfolio Series Growth Fund	4.8	13.8	16.7	7.9	5.9	5.0	3.6 (Dec. 01)
Select Income Managed Corporate Class	0.8	2.2	3.7	3.5	n/a	n/a	3.8 (Sept. 10)
Select 70i30e Managed Portfolio	2.1	6.8	8.9	5.4	5.7	n/a	3.3 (Nov. 06)
Select 50i50e Managed Portfolio	2.9	9.9	12.5	6.6	6.0	n/a	2.9 (Nov. 06)
Select 30i70e Managed Portfolio	3.7	13.1	16.2	7.9	6.2	n/a	2.5 (Nov. 06)

All fund returns are for Class A units/shares

Select Income Managed Corporate Class

The markets generally rewarded risk taking this year with above-average performance in the stock markets and negative returns in the fixed-income markets. We positioned Select Income Managed Corporate Class with very low interest rate risk at the beginning of the year because we believed that interest rate-sensitive investments in general did not provide adequate compensation for their risks. We carried as much as 40% cash and used some of the “risk budget” to buy U.S. dollars – which turned out well for the fund. As a result, we have protected our investors’ capital and earned a modest return in a rather challenging environment.

Following what we called a “re-pricing” in the fixed-income markets, we are finding opportunities to invest the cash. We are wary of extending the term of the bond portfolio, as we believe that long-term rates remain uncertain. Where we are finding opportunity is in short-term, high-quality corporate bonds. For example, two-year corporate bonds offer a yield of about 2% today. That rate is available in government bonds only in terms of five years. Effectively, we are taking very manageable credit risk for lower interest rate risk to earn similar returns.

The cash level has now been reduced to 20% with a portion of it held in U.S. dollars. We believe the portfolio is well positioned to endure different market environments and, at the same time, earn an attractive return for conservative investors who do not want significant equity risk and the volatility that comes with equity investing.

Outlook and positioning

With ultra-low interest rates globally and ample liquidity due to quantitative easing in the U.S., Europe and Japan, it is difficult to find deeply discounted investments. We believe most asset classes are fairly valued and will remain so for a while, as central banks are standing ready to avert any shocks to the markets. The stellar equity market performance of 2013 is unlikely to be repeated in 2014 as we head to more normalized markets. Our expected long-term return on equity is 6-8%, driven mainly by corporate earnings growth and dividends. Market volatility is increasing, investors should be aware that short-term returns will deviate from long-term targets from time to time. It happened in 2013 but the deviation was on the positive side. We rely on our portfolio managers to find companies with better growth, more attractive valuations and higher dividends to produce strong results and they have done an excellent job.

We continue to carry a high level of cash in the portfolios. It serves the dual purposes of countering market volatility and allowing flexibility to add positions in the future. After participating in a stock market rally lasting several years, it is now prudent to emphasize capital preservation.

We have made a few changes to Portfolio Series Income Fund. We recently reduced the cash weighting by about half and allocated assets to Lawrence Park Strategic Income Fund and Cambridge Global Dividend Fund. The Lawrence Park fund is a low-volatility, high-conviction fixed-income strategy that has the potential to add risk-adjusted returns to the existing mix. As the dividend theme grows in our portfolio, we have not only expanded the weighting, but have also diversified the exposure with three different dividend-oriented mutual funds, separately managed by Signature Global Asset Management, Epoch Investment Partners and Cambridge Global Asset Management.