Market Commentary

Third Quarter 2017

CI Multi-Asset™ Management

Portfolio Series and Portfolio Select Series
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CI Multi-Asset Management

Market performance

Canadian investors' returns in recent months have been heavily impacted by the Bank of Canada's surprise decision to hike interest rates (in July and September), which caused bond prices to fall and foreign currencies to depreciate against the Canadian dollar. So while the Canadian stock market (S&P/TSX Composite Index) appears to have outperformed foreign markets during the third quarter, portfolio gains are largely attributable to currency fluctuations. The U.S. dollar lost 3.8% against the loonie during the quarter. In local currency terms, the U.S. stock market, represented by the S&P 500 Index, earned 4.5% (versus 0.4% in Canadian dollar terms), while the global benchmark, the MSCI World Index, gained 4.3% (versus 0.9% in Canadian dollars).

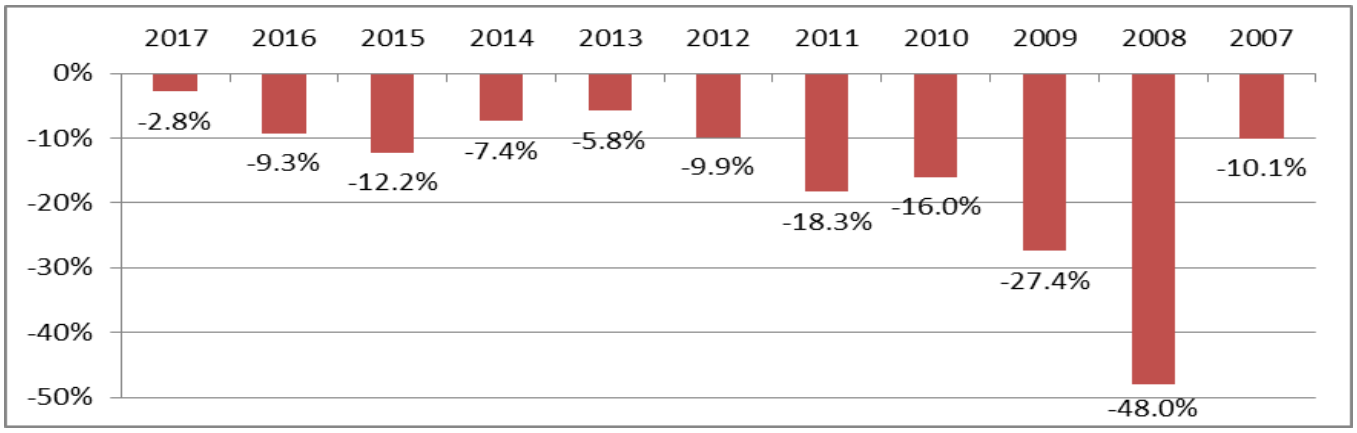
Returns in % at September 30, 2017	**3 mo**	**1 yr**	**3 yr**	**5 yr**	**10 yr**
S&P/TSX Composite Index	3.7	9.2	3.6	8.0	4.0
S&P 500 Index (C$)	0.4	12.9	14.6	19.7	9.9
MSCI World Index (C$)	0.9	13.1	11.9	17.1	7.2
FTSE/TMX Canada Universe Bond Index	-1.8	-3.0	2.8	2.7	4.7

Source: Bloomberg, FTSE TMX

Portfolio Series and Portfolio Select Series

The S&P 500 index had a maximum drawdown of only 2.8% in the first nine months of 2017, compared with 16.4% on average for the last 10 years. (See chart A). This is the maximum loss an investor would record if they bought at the highest and sold at the lowest within the year.

Chart A: Maximum drawdown for each calendar year on S&P 500

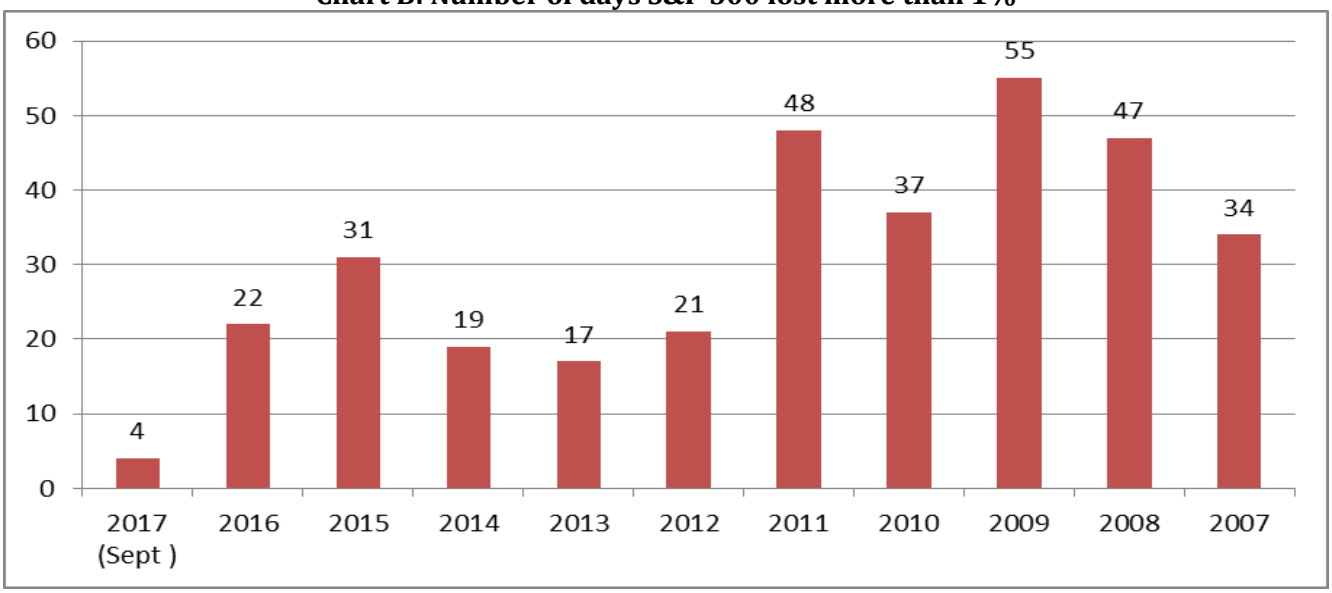


NB. 2017 refers to the year to date
Source: Bloomberg, CI Investments Inc.

If we haven't already convinced you that the strategy of "taking risks and asking questions later" was the best strategy in these circumstances, another statistic may: consider the number of days the market registered more than 1% downside. (See chart B). In the first nine months of 2017, the S&P 500 Index had only four such days. The best period prior to this was a 17-day stint in 2013; the worst was a 74-day period in 2008.

What is difficult to fathom is the unprecedented low level of volatility given major geopolitical developments over the last year. These include U.S. President Donald Trump's tumultuous first nine months in office and historically low approval ratings, as well as the threat of armed, possibly nuclear, conflict between the U.S. and North Korea following mutual threats and provocations.

Chart B: Number of days S&P 500 lost more than 1%



Source: Bloomberg, CI Investments Inc.

While we certainly aren't complaining about low volatility, investors should understand the causes and consequences. Low market volatility and the availability of loans through central banks' quantitative easing (QE) programs have pushed the flow of money towards risky assets. The balance sheet assets of major central banks (the U.S. Federal Reserve, European Central Bank, Bank of England, and those of Japan, Brazil, China and India) have ballooned to 25% of global Gross Domestic Product (GDP). This compares with less than 10% a decade ago. These assets essentially represent money created by central banks and circulated through the financial system (i.e. to other banks, which then have more funds to loan investors). As the demand for assets has risen, prices have increased and volatility has abated. In turn, low volatility has become self-fulfilling at the same time as valuations are starting to disconnect from fundamentals. In our view, the combination of low volatility and robust returns isn't sustainable.

Our portfolios are risk-managed – a strategy that has delivered value over the long-term but one that was particularly challenging this quarter. We have held some government bonds to offset equity risk and to earn income; however, returns on Canadian fixed income were negative for the quarter as price depreciation was greater than income generated. Our exposure to foreign currencies – a direct result of investing overseas – also had a negative impact on returns, although we managed to minimize the effect by hedging. It's worth reiterating the importance of investing overseas, which allows us to access a broader universe of opportunities and to remain diversified with the goal of generating the best risk-adjusted returns for our investors.

Our risk basket, which comprises corporate bonds and equities, has done extremely well amid low volatility. Emerging markets and high-yield securities stand out. But as markets start to disconnect from fundamentals – a situation in which valuations become meaningless to many investors – one shouldn't be surprised by how poorly government bonds have performed, and also by the strength of returns for corporate bonds and

equities. Our income-centric portfolios have performed relatively well, albeit slightly on the downside, while the equity-centric portfolios have underperformed with a positive return.

Holding some cash and investing defensively worked in the income-centric portfolios but detracted from returns in the equity portfolios. Within the equity portion, exposure to emerging markets, and strong stock selection within Europe, Australasia and the Far East (EAFE) markets added value. In addition, not owning some technology companies has cost us on the upside. For example, the electric car company Tesla has gained 60% this year despite losing money on every car it produces. This is just one example of the market's over-exuberance towards certain companies with poor fundamentals.

Returns in % at September 30, 2017 (Class F returns shown)	**3 mo**	**1 yr**	**3 yr**	**5 yr**	**10 yr**
Portfolio Series Income Fund	-0.5	1.6	4.7	6.3	5.9
Portfolio Series Conservative Fund	-0.4	2.5	4.8	7.1	5.3
Portfolio Series Conservative Balanced Fund	0.1	4.2	5.4	8.2	5.5
Portfolio Series Balanced Fund	0.4	5.8	6.2	9.1	5.5
Portfolio Series Balanced Growth Fund	0.9	7.8	6.8	10.0	5.6
Portfolio Series Growth Fund	1.2	8.7	7.1	10.8	5.5
Portfolio Series Maximum Growth Fund	1.7	11.1	8.2	12.4	5.4
Select Income Managed Corporate Class	-1.1	-1.0	2.8	4.0	n/a*
Select 80i20e Managed Portfolio	-0.6	1.3	3.6	5.6	5.0
Select 70i30e Managed Portfolio	-0.3	2.1	3.9	6.3	3.9
Select 60i40e Managed Portfolio	-0.1	3.1	4.2	7.1	5.1
Select 50i50e Managed Portfolio	0.1	4.1	4.6	7.9	5.2
Select 40i60e Managed Portfolio	0.4	5.3	5.1	8.7	5.2
Select 30i70e Managed Portfolio	0.6	6.4	5.4	9.5	5.3
Select 20i80e Managed Portfolio	0.9	8.2	6.2	10.5	5.4
Select 100e Managed Portfolio	1.5	10.5	7.0	12.2	5.7

**Since inception (Sept. 2010): 4.2%*

Market Commentary

CI Multi-Asset™ Management

Select Income Managed Corporate Class

Bond market performance has been negatively impacted by investor fears of interest-rate hikes. However, our portfolio performed well with low downside capture throughout the period. Owning both corporate bonds and equity to offset interest-rate risk was an effective decision. The portfolio was running defensively with lower duration for the bond portion and lower-than-normal equity and credit exposure. We held 15-20% in cash. Still, the return for the most recent period didn't meet our return target of 2-3% per year. As most investors in this portfolio intend to invest for two to three years, we believe there is time to catch up. We expect performance to improve as markets normalize to reflect economic fundamentals.

In light of more attractive fixed-income valuations, we have reduced our cash weighting to purchase both Canadian and U.S. government bonds. As a result, our cash holding now stands at 8% and our government bond weighting has increased to 42% (from an average weight of 36% in the last year). We have also relied on options strategies to cap some of the downside.

Exposure to the U.S. dollar has detracted from performance this year. This exposure amounted to as much as 25% of the portfolio at one point and dropped to 15% as the greenback peaked. We acted aggressively to reduce our exposure, but apparently this wasn't as aggressive as the 9% drop in the U.S. dollar from its peak (May 4) to the end of the quarter (Sept 30).

We believe bond performance may improve given the likelihood that will be little change in interest rates. At current levels, we expect Canada to lose some of its trade competitiveness which could prevent the Bank of Canada from hiking rates further.

We have recently initiated a gold position through a gold bullion exchange traded fund (ETF). The price of gold has fallen to an historic low and we expect limited downside from here. This position serves as a hedge to the riskier component of the portfolio (corporate bonds and equities).

The asset mix as of September 30, 2017 is as follows: cash 8.1%, government bonds 42.0%, investment-grade corporate bonds 17.8%, high-yield corporate bonds 17.6%, equities 11.4% and gold 3.1%. We believe this positioning is highly prudent and should effectively weather any upcoming storms.

Outlook and positioning

The risk-taking that dominated the markets over the third quarter worked well. As a result, many investors are motivated to take ongoing risks based on recent experience, and ignore any potential downside. This has also prompted a self-fulfilling consistent return, low-volatility cycle – arguably, the creation of a bubble. We conclude that we're in the late stage of a bull market –based on declining volatility, increasing valuations and the prevalence of one-sided asset flows – and that we're better off taking a defensive position than chasing winners. Ultimately, we're required to manage your savings, not take undue risks.

It's difficult to say how long this market euphoria will last. But investors should do their homework to ensure they aren't exposing themselves to large unrecoverable losses by investing in companies that don't have a sustainable business model; nor should they lend money to companies that won't be able to repay the funds when the business environment becomes difficult. While everyone may agree on this in theory, many

investors fail to take the necessary steps to protect against the downside. Clearly, in any market cycle, there are opportunities along with risks.

We see value in short duration Government of Canada bonds, as well as long duration (20+ years) U.S. Treasuries and Canadian government bonds. They may be boring but they're ultimately safe as your money is backed by institutions that can print money and impose taxes!

Companies that continue to generate free cash flow are perceived today by the markets as less "exciting" than those that burn cash. We prefer certainty to uncertainty. As a result, we're committed to a diversified portfolio, including investing in out-of-favour asset classes. We also like valuations that are in our clients' best interests and avoid buying assets at any price. While we aren't timing for a market correction, we aren't positioned for insanity either. Market corrections are normal even though we haven't had one for some time. The bottom line is that these corrections create opportunities for real investors.