Market Commentary

Fourth Quarter 2014

CI Investment Consulting

Portfolio Series and Portfolio Select Series

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Market performance

Capital markets performed well during 2014 with only a few exceptions. Oil prices climbed steadily during the first half but fell nearly 50% since September, leading to a sell-off in energy-related stocks and corporate bonds. On a positive note, lower oil prices pushed inflation expectations lower and triggered a government bond rally. The broad Canadian bond markets, as represented by the FTSE TMX Canada Universe Bond Index, gained 2.7% during the fourth quarter and ended the year with an 8.8% return. American stock markets stood out with strong performance that reflected appreciation in both share prices and the U.S. dollar. The U.S. economy continued to move forward with solid GDP and job growth. The Federal Reserve ended quantitative easing in October, though the news was widely expected in advance and had little impact on bond and stock markets. In Canadian dollar terms, the S&P 500 Index gained 8.9% during the fourth quarter and finished 2014 with a 24.3% return.

Returns in % at December 31, 2014	3 mth	1 yr	3 yr	5 yr	10 yr
S&P/TSX Composite Index	-1.5	10.6	10.2	7.5	7.6
S&P 500 Index (C$)	8.9	24.3	25.8	17.8	7.3
MSCI World Index (C$)	4.9	15.4	21.3	13.1	6.3
FTSE TMX Canada Universe Bond Index	2.7	8.8	3.7	5.4	5.3

Source: Bloomberg, FTSE

Portfolio Series and Portfolio Select Series

All CI Portfolio Series and Portfolio Select Series funds earned a positive return during the fourth quarter despite lower oil prices and the sell-off in the energy sector. Our asset mix positioning, which favours U.S. equities and the U.S. dollar while being underweight Canadian equities, emerging markets and the energy sector, continued to add value.

Government bonds have been expensive for some time as a result of central bank policies. With lower oil prices and reduced expectations for inflation, bond valuations have increased further still, to a level that suggests global economies are headed for recession. This contradicts the strong economic data evident in the United States. We believe the premium from holding long-term bonds relative to the cash rate is too little, and the high valuations on bonds are not sustainable with or without recession. As a result, we have been holding more cash and less government bonds to reduce volatility in the portfolios. While we believe this positioning is reasonable, it was unfavourable to the portfolios during the fourth quarter as government

bonds outperformed our cash holdings. That said, we are pleased with our 2014 portfolio returns on both an absolute and risk-adjusted basis. We have included a sample of our results in the table below:

Returns in % at December 31, 2014	3 mo	1 yr	3 yr	5 yr	10 yr	Life
Portfolio Series Income	1.8	7.7	7.6	7.1	5.3	5.4 (Dec. 99)
Portfolio Series Balanced	2.5	8.8	11.1	7.7	5.3	7.1 (Nov. 98)
Portfolio Series Growth	2.5	8.6	13.3	8.6	4.9	4.5 (Dec. 01)
Select Income Managed	1.3	5.7	5.5	N/A	N/A	4.4 (Sept. 10)
Select 70i30e Managed Portfolio	1.4	6.4	8.4	6.4	N/A	4.1 (Nov. 06)
Select 50i50e Managed Portfolio	1.4	6.9	10.4	7.3	N/A	4.0 (Nov. 06)
Select 30i70e Managed Portfolio	1.6	7.5	12.4	8.3	N/A	3.8 (Nov. 06)

All fund returns are for Class A units/shares

Select Income Managed Corporate Class

The Select Income portfolio continues to deliver attractive "inflation plus" returns on a rolling basis without the large interest rate risk investors assume in a more traditional 100% fixed-income bond portfolio. As a testament to this, over the last 36 months, Select Income has had 30 positive months, compared to only 23 for the FTSE TMX Universe Bond Index.

We are comfortable adding risk as long as we believe we will get paid adequately to do so. It has been difficult in the income sector to find bargains, as certain asset classes such as government bonds appear very overvalued. We are taking very little interest rate risk and holding a larger amount of cash. Our risk budget is being used in areas that offer more attractive returns, including corporate bonds, the U.S. dollar and a basket of selected real estate income trusts and dividend-paying stocks. We expect bond valuations to decline during 2015 and there could be opportunities for us to rebuild a more significant government bond weighting over the course of the year.

Outlook and positioning

The "known unknown" for 2015 is central bank policy. It is widely expected that the U.S. Federal Reserve will start to raise interest rates, perhaps by as much as 100 basis points. Canada's rate policy will likely lag that of the U.S. because our rates are already 100 basis points higher and lower oil prices will tend to reduce the growth rate of our economy, despite the positive impact on consumers. We expect central banks to be flexible with their policy, as the first objective is to avoid a shock to the economy, which is still operating far from full capacity. With an improving economy, interest rate increases – as long as they are implemented gradually – should have a limited impact on the earnings growth of companies and the value of the stock markets.

It matters little whether rates start to rise during the first or the second half of the year. In a rising rate environment, the best-case scenario for bonds is to earn a return that is equivalent to current yields. The Government of Canada bond with a 10-year term is yielding less than 2%, which implies a return lower than the expected inflation rate for investors. We remain cautious and own only enough bonds to offset other

risks to the portfolios. We will feel more comfortable adding to our bond holdings when their yields offer a premium to expected inflation.

Current valuations and corporate earnings suggest that a future average annualized rate of return of about 6-8% for stocks is reasonable. This represents a 4-6% premium over the 10-year U.S. Treasury yield, and is consistent with the historical average. The good news is that market volatility may remain suppressed as central banks are committed to act in unfavourable circumstances. In addition, solid corporate balance sheets with large amounts of cash provide companies with flexibility and the ability to weather short-term challenges. The largest 500 companies in the United States are returning about 5% annually to shareholders through share buybacks and dividends alone. Therefore, the expected return of 6-8% is a reasonable target.

Amongst all developed countries, the U.S. appears to have the most favourable fundamentals. Its economy is on a solid track, the central bank is flexible, many companies are multinational, and its market is well diversified and not skewed to the resource sectors. Most importantly, valuations are reasonable. In our portfolio solutions, we remain overweight U.S. equity and underweight Canadian equity and emerging markets. However, for every dollar invested in U.S. equities, our currency exposure is approximately 50 cents as a result of our foreign exchange hedging program. We are not in a hurry to add to our holdings in Canada or in the energy sector generally, despite the recent sell-off. Valuations have not improved dramatically as future earnings have fallen sharply with lower oil prices.

Overall, we are positioned prudently going into 2015, a year in which we may see rate hikes and increased volatility in the bond markets. We have flexibility in both the income and equity portions of our portfolios in terms of geography, sector, currency and the selection of companies and can react to valuation changes in an appropriate period of time when market conditions change.