Market Commentary
CI Digital Roadshow

MARRET ASSET MANAGEMENT INC.

Summary of a presentation by Marret Asset Management
September 22, 2016

Portfolio Manager Paul Sandhu on investment-grade bonds and CI Investment Grade Bond Fund

- **Macroeconomic outlook**
    - Continued slow global economic growth, no recession.
    - We expect interest rates to be "lower for longer," with the U.S. Federal Reserve raising rates once this year and once in 2017, with the 10-year Treasury yield trading in a range of 1.0%-1.75%.
    - No rate changes in Canada and continued quantitative easing in Europe, Japan and the U.K.
    - Key market risks: Slow Chinese growth, energy/commodity prices, European elections, post-Brexit negotiations, and the Italian constitutional referendum.
    - Key credit market risks: recession, weaker commodity prices, a spike in interest rates, and U.S. dollar strength, which hurts emerging markets and corporate earnings of multinational U.S. companies.
- We believe investment-grade bonds can provide strong risk-adjusted returns in a challenging fixed income landscape for the following reasons:
    - They provide additional spread, or carry, over government bond yields.
    - There are opportunities for us to generate alpha, or excess return, through, for example, issuers that are deleveraging. There are many examples of this globally, particularly in Europe.
    - They offer quality, liquidity and potential for global diversification.
    - We expect increasing volatility that will make active management of duration and credit risk even more important.
- We expect interest rates to trend slightly lower due to low inflation, disappointing global growth, very high levels of government indebtedness globally, and quantitative easing in certain regions. The U.S. Federal Reserve is not tightening, but is seeking to normalize rates to a neutral level, which appears to be more like 1.25% as opposed to 2% as in the past, which supports our lower for longer view.
- Credit fundamentals have been weakening lately, but are showing signs of stabilizing. While revenue has been declining, profit margins have remained strong. The overall increase in corporate leverage has been driven by A to AAA-rated companies, as a result of share buybacks, increasing dividends, and M&A, while BBB-rated issuers have been reducing leverage.

- Technical factors are very supportive of corporate bonds, and these include: purchases of corporate bonds by the European Central Bank, the Bank of England and the Bank of Japan; significant inflows into bond funds this year; offshore purchases of investment grade credit in both Canada and the U.S. by yield-seeking Asian and European investors; and reduced supply of bonds relative to demand.
- We believe active management, including portfolio construction, diversification and the ability to hedge risk, are very important today in fixed-income portfolios.

Chief Investment Officer Barry Allan on the high-yield market

- The high-yield market has performed well this year, driven by the highest-risk areas, energy and metals and mining, which were recovering from steep downturns last year and early this year.
- Safe yield is hard to find. With high valuations, you require creativity, hedging capacity, and tactical management. We don’t think it will be rewarding to just set a strategy at the beginning of the year and let it play out.
- In the last four to five months, there has been the unusual situation in the high-yield market of defaults rising and spreads falling. (The spread is the yield premium offered by high yield relative to government bonds.) This shows the market expects defaults to decrease.
- The default rate is above 6%, which historically has accompanied a recession and even higher default rates. We believe this cycle will be the exception because recent defaults are primarily a result of difficulties in the energy sector, which represents the biggest industry weight in high yield. These issues are being worked out and we expect default rates fall next year to around 4%.
- The key to bond yields is inflation and we believe inflation will remain low. We’re not structuring our portfolios to protect against rising inflation and, therefore, the start of a secular rise in bond yields.
- Even if we're wrong on interest rates, high yield tends to perform much better than other fixed income when rates are rising because it’s more correlated to the economy. If rates are rising, that's generally because the economy is stronger and inflation is picking up and that's good for the balance sheets of high-yield companies.
- We expect increased volatility next year, with the potential for a couple of meaningful sell-offs. This year, high yield has traded in a range of 6% to 10% yield, a very wide range. Spikes in volatility have tended to be buying opportunities.
- We do not see a recession next year, but you have to be cognizant of valuations. Valuations of everything in the world are being stretched and that leads you to be cautious.
- So we’re going to maintain a defensive stance, except after we get these short, sharp sell-offs, and then we'll become more aggressive, buy into those sell-offs. Then, when the market comes back, we’ll take our profits and revert to that defensive stance.

- We look at the markets very tactically. We do not want to take a lot of risk in case some geopolitical event causes a much bigger problem but we believe the fundamentals are supportive of high yield.