

January 24, 2018

## CI Digital Roadshow 2018

Summary of presentations by Sentry Investments:

**Sandy McIntyre**, *Executive Vice-Chairman & Director*

**James Dutkiewicz**, *Chief Investment Officer*

**Michael Simpson**, *Senior Vice-President and Executive Portfolio Manager*

**Aubrey Hearn**, *Vice-President and Senior Portfolio Manager*

**Michael Missaghie**, *Vice-President and Senior Portfolio Manager*

**Jon Case**, *Portfolio Manager*

### **SANDY MCINTYRE**, *Executive Vice-Chairman & Director*

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- There have been changes following the acquisition of Sentry by CI, but the direction of the portfolio management team is clear:
  - James Dutkiewicz was named Sentry CIO, while continuing to run fixed-income team. He will continue working closely with portfolio managers Michael Simpson, Aubrey Hearn, Mike Missaghie and Jon Case to deliver Sentry’s unique investment style, which remains unchanged.
  - While there is no change to the Sentry investment culture, there were changes to a small number of funds. CI teams such as Signature Global Asset Management and Cambridge Global Asset Management were appointed sub-advisors, providing unitholders with improved portfolio management capability.
- Jon Case runs the natural resources portfolio and has taken over as lead on precious metals, while Michael Missaghie continues to lead the global REIT fund.
- James continues to manage the fixed-income team, and is well supported by Catherine Payne; their skill sets are critical to our portfolio solutions.
- One of the key reasons for CI’s acquisition of Sentry is its expertise in North American equities and our specialty of equity income. Mike Simpson and Aubrey Hearn will continue to lead the way there, and they are ably backed by a deep team of experienced analysts and associate portfolio managers.

### **Moving forward together**

- Any new business combination takes time to come together, but Sentry portfolio managers are committed to supporting clients, and they remain focused on what Sentry does best.
- As the cycle matures, investors increasingly chase returns, forgetting that risk management matters. Downside capture ratios are forgotten in a world where cheap passive solutions are an easy sale.
- Cornerstone Macro noted on January 19 that:
  - The S&P 500 set a record for “days without a 3% correction” (302), and it has now set a record for “days without a 5% correction” (396).

- That is a long-time to go without defence being valued.
- Key to long-term success in portfolio management is to participate on the upside and defend your capital when markets turn against you – defence matters. That is where Sentry thrives.

### JAMES DUTKIEWICZ, *Chief Investment Officer*

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- Sentry continues to have a strong and seasoned portfolio management team, with a wealth of experience and expertise, and a consistent investment approach.

#### Fixed-income investment approach

- Sentry continues to manage fixed income, which is represented in the Sentry Personal Pension Portfolios, and in a number of balanced mandates.
- A flexible, multi-strategy approach helps position the funds for outperformance in a variety of markets and helps deliver strong risk-adjusted performance by:
  - Strengthening risk management
  - Diversifying sources of return
- In its credit investment process, Sentry seeks secure, superior risk-adjusted returns through a combination of top-down and bottom-up opportunity analysis. It takes a similar approach to the equity investment team, focusing on company:
  - Income statements – quality of cash flows
  - Balances sheets – return on invested capital, discover liabilities
  - Risk analysis – what could go wrong? Are we getting enough return to balance off the risk?
  - Relative valuation – yield vs. duration trade off.

#### Fixed-income outlook

- Market is only slightly at odds with U.S. Federal Reserve direction over where short-term rates are going
  - over past five years, the bond market has been in line with what the Fed has been saying. Expect rate increases in Canada and U.S. to be gradual, with the level depending on variety of influences.
- Sentry prefers corporate credit over sovereign debt –supported by synchronous global earnings growth. High yield and investment grade has outperformed Treasuries during periods of rising rates.

#### Overall Sentry asset allocation:

- Underweight: Fixed income (core and high yield), real assets
  - Sentry expects modest increases in interest rates and inflation, and maintains a short duration
- Overweight: Equity (Canada, U.S. and international)
  - Supported by global growth, monetary policy should normalize gradually.
  - As an example, within Sentry Personal Pension Portfolios, the balanced portfolio typically targets a 50/50 balance between equity/fixed income, but is at 58% equity.
  - Most significant overweight is to the U.S. (strongest economy despite higher market valuations); also a significant overweight to international markets with strength in Europe and increasing strength and opportunity in Asia; a slight overweight to Canada as a result of some undervalued sectors that are now performing.

## Investment philosophy

- The Sentry team believes in:
  - Investing in high-quality businesses with strong balance sheets, and trading around average or lower-quality businesses.
  - Finding opportunities created by market view extremes (optimism or pessimism)
  - A focus on dividends, and constructing conservative dividend portfolios.
- The team uses a variety of tools to identify companies with the following characteristics:
  - High return on capital and equity, low leverage on balance sheets
  - Positive and rising free cash flow, with history of prudent capital allocation
  - Management with strong operational experience and ownership
  - Oligopolies
  - Their holy grail is companies that consistently grow their dividends over time.

## Investment approach

- Own the best companies. Dividend growers and payers have outpaced the growth of S&P/TSX Composite Index with less volatility.
- Be dividend champions. Sentry Canadian Income Fund companies increased their distributions by an average of 10.2% in 2017.
- Outperform over the long term, with lower volatility
  - Sentry Canadian Income Fund has outpaced the Canadian Focused Equity category and S&P/TSX Composite Index with lower standard deviation since inception of the fund (Feb 15, 2002).
- The team works hard to find strong companies and will not overpay for the latest trends
  - Amazon, Netflix, Tesla, Canopy, etc., have market caps far ahead of revenues
  - Avoided historical high flyers like Valeant Pharmaceuticals
- Deliver a smoother investment experience – discipline pays off
  - Participate in rallies, protect in downturns – since inception, Sentry Canadian Income Fund has had a 77% up capture and 40% down capture of the market.

## Sentry holdings that aren't currently favoured by the market

- AltaGas – offers growing dividends
- Enbridge – predictable cash flow
- Morneau Shepell – recurring revenues, 98% client retention
- CVS Health – strong management team, solution for lowering the cost of health care
- THEY ARE NOT THE INDEX – Sentry Canadian Income Fund has 86% active share

## Market outlook

- The team sees modest economic growth in Canada; U.S. should grow at a higher rate. They intend to increase U.S. exposure as opportunities arise.

- All sectors have not participated in the market rally and the team is seeing attractive valuations due to negative sentiment.
- Modest inflation means smaller rate increases

**Key thought:** Blockchain – attractiveness based on differentiation between the technology (which larger tech companies will inevitably adopt) and the cryptocurrencies (which remain speculative).

**AUBREY HEARN, Vice-President & Senior Portfolio Manager**

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### Why U.S. equities?

- World's largest economy – 25% of global GDP in 2016 (Canada was 2%).
- Opportunity – Over 30-year period (1987-2017), U.S. small cap stocks led in performance with a 10.3% return on an annualized basis.
- Exposure – To health care (aging demographic and increased utilization, many great companies to consider) and technology sectors with positive tailwinds.
- Multinational revenue – Approximately 40% revenue derived from foreign countries and emerging markets, where there are less incumbents to compete with established experienced U.S. companies.
- Appealing alternative to other asset classes, especially in low interest rate environments
- NOTE: Sentry U.S. Monthly Income Fund outperformed 98% of peer group since inception.

### Why invest in small caps like Sentry Small-Mid Cap Income Fund? They:

- Have delivered higher returns with marginal risk added.
- Have generated higher revenue growth than large caps, because companies grow faster.
- Benefit from proposed Trump administration policies – tax changes should be more impactful for small caps.
- Offer better valuations due to less analyst coverage.
- Exhibit more diverse returns by servicing niche markets.
- NOTE: Sentry Small/Mid Cap Income Fund outperformed 100% of peer group since inception, has 85% active share.

### Investment approach

- The team is index-agnostic, thinks about owning a business a 10-15-year mindset and looks for companies with:
  - High return on capital and equity – what's the percentage and how much can you put into the business, how fast can it grow?
  - Low leverage
  - Positive and rising free cash flow, not capital-intensive businesses
  - Low earnings volatility – hard to make big economic bets
  - Prudent capital allocation, management with strong operational experience, e.g., Brookfield, Liberty Global
  - Oligopoly – e.g., health care insurance; only two companies per state, credit cards, etc.
- Approach focuses on higher return on equity and less debt, and has led to better downside protection than peers and strong long-term performance throughout the market cycle.
- They think about where they can make money, rather than matching an index – provides access to a lot of different companies.
- Performance in down markets is a key driver in their long-term performance.

## Outlook

- Overall valuations within the North American equity markets remain elevated. However, the team is finding companies trading at attractive valuations due to negative sentiment; many companies haven't participated in the rally yet.
- Sentry sees low risk of recession in Canada and the U.S. The team is more bullish on the U.S. where consumer is healthy with unemployment at decade-low levels, while concerns about Canadian consumer debt are at all-time high.
- Trump may under-deliver on some campaign promises, but the pro-growth agenda is expected to be positive for the U.S. economy. While there is U.S. political instability:
  - Republicans control Congress, which provides enforceability for policy change
  - Policy changes have been additive to the U.S. economy
  - Risk of impeachment exists, but even if it happens it may not lead to large market fluctuations.

**MICHAEL MISSAGHIE**, *Vice-President & Senior Portfolio Manager*

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## Overview

- Real estate (commercial, income-producing assets) can be a great complement to your portfolio. How do you access commercial real estate?
  - Private: Buy direct assets and manage the asset. It can be capital intensive, illiquid, have high fees and perceived lower volatility
  - Public: Invest in shares of a real estate investment trust (REIT), which invests in the same type of real estate but it is professionally managed, liquid, transparent on costs, but comes with perceived level of higher volatility

## Why invest in REITs?

- One of the best ways to access commercial real estate and its income flows because of:
  - Attractive yield and growth, tax-efficiency that comes with yield
  - Low correlation with typical portfolio investments – the asset class is a solid diversifier, especially over long timeframes
  - Increasing pension fund and other institutional investment/demand in the sector
  - Increased investor attention and growth of sector, now recognized as separate asset class
  - REIT structure in place in most developed countries, allowing for global investment.

## Investment approach involves elements unique to this sector

- Management: The team seeks REIT management with a strong track record, long-term strategic focus, ability to generate cash flow
- Assets: Well-located and fit within long-term business strategy, along with strong cash flow generation
- Payout ratio: Sustainable, integrated, consistent, and growing distributions
- Leverage: Debt is appropriate but needs to be managed, integrated, and strategic – limited debt coming due in the short term. Lower leverage on hotels, higher on long-term items like office space.
- Sentry Global REIT Fund offers unique investment philosophy, strong performance and higher yield (paid monthly) vs. peers.

## Macro factors – current short-term influencers and opportunity creators

- Interest rates (perceived negative, but positive rates with strong economic growth should lead to higher occupancy rates and net higher cash flow)
- Fund flows (negative)
- Supply vs. demand of real estate in key markets (positive)
- Occupancy and rent trends (mixed)
- Private real estate capital investment and values (positive).

JON CASE, *Portfolio Manager*

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## Themes driving demand for resources over next 10 years:

- Demographics. In Asia, the population is growing quickly, Sentry anticipates 100% GDP growth per capita to \$10,000; Asia expected to account for 40% of the total dollar increase in world GDP over the next 10 years.
- As a result, there should be growing investment in infrastructure – including significant growth in electricity need and consumption
- Disruption – the adoption of electric vehicles has big implications for battery material providers (renewable power generation is metal intensive). Battery material providers make up about 40% of the Sentry Canadian Resource Class, oil and gas less than 10%.

## Precious metals

- Gold demand cycles: Long-term (wealth driven), medium-term (diversifier) and short-term (safe-haven buying)
- Two types of gold investors:
  - Those hedging in response to the risk of currency fluctuations and growing debt levels, particularly in the U.S. – stronger demand from this category of investor right now
  - Those using it as a return driver, especially in times of equity sell-offs –demand weaker with this type of investor right now.

## Sentry Precious Metals Fund

- Invests in precious metals equities – the companies digging the metal out of the ground
- High active share because large-cap gold companies that you might find on indexes have lower cash yields and poor growth prospects
  - Top nine names in the index represent 40% and large debt, would take approximately 90% of the ore in the ground to pay back the debt – you can only make money in those companies if gold price goes up
- The team looks for companies that can make money in flat gold price environment; there are three drivers of that:
  - How much cash the business generates.
  - How much wealth they are finding (gold version of ROI).
  - How investors' valuation of gold companies changes over time. Trying to profit from discount rates as companies go from exploration to development and production – that takes technical expertise and hard work.
- Silver – companies trade at twice the valuation, hard to find attractive options.
- Copper – linked to emerging market development, alternative energy, and electric vehicles; good opportunities here.

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