Market Commentary
Third Quarter 2016

CI Investment Grade Bond Fund

Divergent monetary policy was a key theme in the quarter. Post the Brexit referendum, the Bank of England cut interest rates and introduced further quantitative easing measures. In the U.S., a strong July payrolls number increased the probability of an interest rate hike by the Federal Reserve. Persistent sluggish growth and low inflation allowed both the Bank of Canada and the European Central Bank to maintain a bias toward downside risks in the economic recovery. During the period, 10-year government bond yields rose 13 basis points in the U.S. while those in Canada and Europe declined by five basis points.

Supported by low volatility and a recovery in oil prices, industrial economy equity markets rose 3% - 5% in the quarter. This was supportive for investment-grade credit spreads which also benefitted from increased quantitative easing and higher yields in the U.S. market. The U.S. investment grade corporate credit default index (CDX) tightened over four basis points while the comparable European index was almost eight basis points tighter.

The fund has a higher exposure to U.S. dollar denominated corporate bonds relative to the benchmark, which is 100% Canadian. As a result, the outperformance of Canadian government bond yields (which declined while those in the U.S. rose) slightly detracted from performance. Active management of our duration via U.S. Treasury bonds and futures, a recovery in European bank bond credit spreads and strong performance from our exposure to Qualcomm and Cox Communications helped to offset the detractors.

Looking forward to the final quarter of the year, we are cautious on both rates and credit. Credit spreads are near the tighter end of our expected trading ranges. Technicals in the credit markets (central banking buying, foreign buying, strong fund inflows and a demand/supply imbalance) are, for the moment, trumping fundamentals. We will look for any further tightening to take profits and reduce credit exposure. The fund has remained short duration relative to our benchmark for a considerable period. We believe that the 10-year U.S. Treasury range is still 1.45% to 1.75% but with a stronger probability that we will test the higher end of the range and may potentially exceed it in the short term. Accordingly, active management of duration has taken on additional importance and reducing duration further may be prudent to preserve relatively good returns year-to-date.

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