Market Commentary
Fourth Quarter 2018

SIGNATURE GLOBAL ASSET MANAGEMENT™

Sentry Global High Yield Bond Fund

Performance summary

- The fund returned -2.7 during the quarter. Specific contributors to performance in the fourth quarter were the term loan for Parq Holdings, the hybrid Citi 7.875% securities, and the 8.5% Studio City bond that was partially called at year-end. Detracting from performance were energy positions in oilfield services bonds like Calfrac and Precision Drilling.

Positioning and current opportunities

- Large swings in core positioning quarter-over-quarter is not typical of our strategy. We focus on investing in high-quality high-yield bonds and alternatives that can drive strong risk-adjusted total returns. The fund had a defensive bias in 2018 which mostly protected capital. This positioning will persist in 2019 although the market is now better rewarding us for risk and there are some tactical trading opportunities.

- As investors began to discount the trajectory of the U.S. Federal Reserve's hiking cycle in 2019, the last bastion holding up the loan market – the prospect of ever-increasing coupons faded and, exacerbated by poor trading liquidity, the market wobbled. From a trading perspective, the weakness in loans made a lot of sense as non-core investors sold loan positions at or near par to buy high-yield or BBB-rated bonds at prices well below par. In bond lingo, that is picking up positive convexity or the ability of a bond's price to rise more as the yield falls. About 20% of the $1.5 trillion loan market is held in daily liquidity mutual funds, while approximately two-thirds is held in collateralized loan obligations with more permanent capital. Where our positioning in loans (17% of Signature High Yield Bond Fund II) proved defensive for the first 10 months of the year, in November, loans began moving in lockstep with high-yield bonds.

- Illiquidity introduces gap risk into portfolios which can work both for and against us. Liquidity proved important in the fourth quarter and will be important in the first quarter to take advantage of opportunities at better valuations. At year-end, half of our large position in Macau-based casino operator Studio City 8.5% bonds due 2020 was called, and in early 2019 we expect to put our position in Trinidad Drilling 6.625% bonds due 2025 back to the company at 101 upon its acquisition by Ensign Energy Services.

- The drop in the oil price and credit spread widening on BBB downgrade concerns provided an opportunity to add the hybrid securities of Enbridge to the portfolios. These bonds mature in 2077 but are callable in 2027 at which point they lose partial equity treatment.

The logic of this trade is akin to our thinking on financial fixed-floating preferreds which we have previously discussed. At our purchase price levels on the Enbridge bonds, yields were 7.5% to the 2027 call.

Risks and things on our radar

- Sentiment in the credit markets, high-yield bonds included, is poor which is usually a bullish indicator. When pressed for their rationale for their bearishness however, we find many investors at a loss for words and simply point to the duration of the current economic cycle, conveniently forgetting the mini-default cycle centered on the energy sector in 2016. Since 1987, in periods when global growth is decelerating, but remains positive, high yield has posted an average annual return of 9.4% (excluding the 57.5% rally in 2009) and in 31 years has never posted negative returns in consecutive years.

- We expect high yield to rebound in 2019 as defaults are likely to remain low. We think higher-beta positioning will be rewarded in the first half of the year. Reversing our call from mid-2018, we now think fixed-rate (high yield) will outperform floating (term loans) in 2019.

Outlook

- We are lifting our outlook on high-yield credit to neutral as spreads are now materially wider and back to historical averages.

- With monetary policy normalization the rising tide of falling bond spreads seems over. Yet, valuations are fair and spreads, on average, could tighten a bit from here in 2019 if U.S. growth remains positive and our Fed 'pause' scenario comes to fruition. We expect higher-beta positioning to perform well in the first half of the year. That said, with more dispersion should come more opportunity for credit selection to drive performance.

- Away from the macroeconomic and the idiosyncratic, the technical things that had us cautious in mid-2018 – complacency, the risk of BBB bonds being downgraded into high yield and overwhelming the market like Ford and GM in 2005 – have materialized or now priced in.

Class F Returns (in %) as at December 31, 2018	Year-to-date	1 year	3 year	5 year	Since inception (5/28/2010)
Sentry Global High Yield Bond Fund	-1.3	-1.3	4.7	4.3	4.7

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