Market Commentary
Third Quarter 2018

Signature Canadian Balanced Fund

The S&P/TSX Composite Index was one of the weaker stock markets globally in Q3, on account of weakness in energy, as oil prices corrected, and materials. Even Canadian banks were weak, while industrials was one of the better performing sectors. Interestingly, the weakness in these two cyclical sectors does not suggest a global economic slowdown. In fact, economic data continues to confirm the continuation of a global synchronized recovery as European economies in particular continue to improve.

The Bank of Canada (BoC) hiked interest rates in July, the second time this year, to 1.5%. While economic data have evolved broadly in line with BoC forecasts, business uncertainty induced by NAFTA (now U.S.-Mexico-Canada Agreement, or USMCA) re-negotiations has led the BoC to proceed with caution in its rate-hiking cycle, keeping rates unchanged at its September meeting. However, the resolution of trade negotiations with the U.S. and Mexico removed what was arguably the single greatest risk to the BoC policy rate path.

The fund (Class F) returned -0.4% in the quarter. Leading performers included Shopify, the Canadian cloud-based commerce platform, and Alibaba, the largest Chinese e-commerce platform.

Materials also contributed marginally thanks to companies like Lundin Mining and Tahoe Resources.

Energy performance was weak, with companies like Encana detracting as they were caught in the oil price decline. Energy weakened through most of the quarter as oil inventories, which were declining, reversed as U.S. shale production rebounded. In the last week of the quarter, oil and energy in general rebounded.

We generally remain bullish on risky assets and equities in particular. During the quarter, exposure to technology was increased slightly.

Duration and yield curve positioning added to portfolio alpha, stemming from our moderate duration position in longer maturity Canadian bonds. The Government of Canada 10-year bond yield rose by some 26 basis points over the quarter. Corporate credit exposure was also alpha accretive, as spreads narrowed five basis points in this sector among the 10-year and shorter maturities during the reporting period.

U.S. dollar exposure net of hedges was a slight drag on alpha, due to the U.S. dollar slipping lower against the Canadian dollar in the quarter. Portfolio foreign currency positions are actively managed through a hedging overlay.

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Portfolio duration is moderately short, featuring a low exposure in the 10-year to 20-year portion of the yield curve. Provincial bonds are used to manage much of this yield curve position, while collecting better income. In the spread product sphere, we have a modestly high exposure to corporate credit, low exposure to Canadian government agency debt, and retain small long positions in U.S. inflation-linked bonds.

The Canadian dollar may continue to rally against the U.S. dollar as markets anticipate a Bank of Canada rate increase in November because global investors remain negatively positioned against the loonie. Any further strength in the Canadian dollar is not, in our opinion, sustainable longer term.

Markets also appear to be transitioning from growth back to more value-oriented sectors. Technology has been a strong performer since the beginning of the year, while global financials and health care have stalled. Recent market moves suggest this may be reversing.

The outlook for equity markets continues to be positive on account of easy financial conditions, which remain intact despite higher short-term U.S. interest rates and statements from a number of central banks on the prospect of tightening monetary conditions via higher interest rates. This can be explained by the continued global synchronized recovery, which has accelerated in Europe in particular and continued in emerging markets. Central banks like the Bank of Canada, Bank of England, and European Central Bank are making the case for more normalized monetary policy (higher interest rates). In addition, the U.S. Federal Reserve has declared that it will begin reducing the size of its balance sheet. We will be closely monitoring the impact of these developments on financial conditions.

Although the growth outlook remains constructive in major economies, particularly in the U.S., we note downside risks as global markets adjust to the reversal of accommodative financial conditions, which have been in place for the last decade. As such, we stand ready to manage these risks in the portfolio by adding duration (interest rate exposure) and/or reducing exposure to credit spreads.

Class F Returns (in %) as at September 30, 2018	**Year-to-date**	**1 year**	**3 year**	**5 year**	**10 year**
Signature Canadian Balanced Fund	1.1	5.8	6.4	7.2	7.1

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