Market Commentary
First Quarter 2018

SIGNATURE GLOBAL ASSET MANAGEMENT™

Signature Canadian Bond Fund

While 2017 was marked by compressed volatility and outperformance of risky assets, the first quarter of 2018 saw the return of uncertainty and volatility within markets. President Trump's tax bill helped kick off the new year with the expectation that its impact on an already strong U.S. economy would increase inflation. The effect caused government bond yields to rise dramatically in January. By the end of March, the escalation of a possible trade war between China and the U.S. was enough to prompt risk spreads to widen and the U.S. government bond yields to retrace, with the U.S. 10-year Treasury yield ending the quarter at 2.76%. Similarly, the 10-year Canadian bond yield rose for most of 2017, but took a step back in February and March, ending the quarter yielding approximately 2.10%.

Monetary policy for the period resumed its slow pivot of normalization. Both the Bank of Canada and the U.S. Federal Reserve raised rates in the first quarter of 2018. The Bank of Canada increased the overnight target rate to 1.25% in January and was cautious regarding the prospects for future shifts, as NAFTA talks continue unresolved.

South of the border, the Fed – under newly elected Chairman Jerome Powell – raised rates in March to a range of 1.5% to 1.75%. The European Central Bank and the Bank of Japan remain further behind, with both central banks providing accommodative policy, but signalling that the end of such policy is within sight.

Spreads for risky assets, in particular corporate bond and emerging market debt (U.S. dollar debt), widened in the first quarter of 2018, but are still significantly below their long-term averages.

Performance
The fund edged ahead by 0.03% in the first quarter. The total return outcome of the portfolio was primarily driven by the drop in longer-term Canadian interest rates, offset by a significant widening of Canadian government credit spreads. On a relative-to-benchmark basis, duration and yield curve positioning was the main source of underperformance

Contributors to performance
Within the spread product sphere, overweight exposure to inflation-linked bonds was beneficial for alpha, given their outperformance relative to their respective nominal government benchmark bonds. Corporate credit selection and underweight government credit positioning was also alpha accretive, with 10-year Ontario spreads widening some 9 basis points during the quarter.

U.S. dollar exposure net of hedges was supportive for alpha, as the greenback advanced against the Canadian dollar over the quarter. Foreign currency positions in the portfolio are actively managed through a hedging overlay.

Detractors from performance

Duration and yield curve positioning subtracted the most from portfolio alpha, due to the underperformance of our U.S. duration exposure relative to Canadian duration. U.S. 10-year yields rose some 29 basis points more than their Canadian counterparts during the quarter.

Portfolio positioning

The portfolio duration sits close to the benchmark, with a lingering underweight in the 20-year area of the yield curve. Provincial bonds are used to manage this yield curve position, while collecting better income. In the spread product domain, we are moderately overweight corporate credit, underweight Canadian government agency debt, and retain modest positions in U.S. dollar-denominated agency mortgages and inflation-linked bonds.

Over the first quarter, we added to Canadian duration mainly in longer maturities, and shifted exposure toward this area of the yield curve from shorter-maturity Canadian bonds. In addition, we sold our U.S. investment-grade emerging market sovereign debt holdings and tactically increased our U.S. inflation-linked bond positions early in the period, before moving most of this exposure back to the Canadian market later in the quarter.

Outlook

Although risky assets have pulled back due to rising interest rates and an increased risk of a trade war on numerous fronts, global growth remains constructive. We continue to advocate a well-diversified portfolio of exposure as the best way to navigate the current environment in fixed income, including duration positioning across different portions of the yield curve, credit spreads, interest rate volatility and inflation compensation.

Class F Returns (in %) as at March 31, 2018	Year-to-date	1 year	3 year	5 year	10 year
Signature Canadian Bond Fund	-0.1	-0.4	0.3	2.1	3.6

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