Market Commentary
Second Quarter 2018

Signature Corporate Bond Fund

The second quarter of 2018 was dominated by rhetoric from the Trump administration on tariffs and trade wars. It began as a trade dispute but deteriorated into a trade war by the end of the quarter. The tariffs continue to be part of a tactic to drive concessions from U.S. trading partners, including China, Europe, Canada and Mexico.

Canada generally fared well amid the growing uncertainty, on account of the energy sector in particular and materials, both late cycle sectors. Strong first-quarter earnings and relief from elevated volatility levels allowed equities to trend higher in the second quarter but the story in fixed income was more complex. Global synchronized growth persists although European growth momentum seemed to slow but was less relevant than political developments. Italy was topical in the second quarter as government bond yields sold off more than 200 basis points at one point on the prospect of a potential anti-European Union coalition government. U.S. economic indicators were strong and Canadian indicators were mixed. Investors continue to weigh the significance of the flattening yield curves in both markets, typically indicative of higher recession risk. However, inter-rating spread compression was the theme of second quarter trading behavior as investment-grade bonds widened 13 basis points (ICE BofAML U.S. Corporate Index) and emerging market bonds gapped out 62 basis points (JP Morgan Emerging Market Bond Index) but high-yield bond spreads were unchanged (although yields were 18 basis points higher at 6.53% to end the quarter). For example, spreads on the high-yield countries like Turkey, Argentina, and South Africa were at their widest levels since Q4 2016, while CCC spreads – the lowest rung of performing high-yield corporate bonds – were at their lowest levels since Q3 2014. Typically, these asset classes move together but the breakdown in correlation can be attributed to dramatic flows, supply and quality differences. There is a note of caution warranted here about drawing conclusions from markets and indexes dominated by both large issuers and idiosyncratic risk.

The defensive positioning that helped us in the first quarter worked against us in the second quarter, mitigated however by the appreciation of the U.S. dollar. On average during the quarter, 70% of the fund's 94% total exposure to the U.S. dollar assets was hedged back to the loonie for effective fund exposure of approximately 25% to currency moves. The financial preferred shares we own in lieu of a higher weight in fixed-rate high-yield bonds were a drag on performance, caught up in the same rise in short-term U.S. dollar funding that has caused European and Asian-based investors to sell higher-rated bonds as after-hedged yields are now less attractive. We sold our long-time positions in Veresen Midstream L+300 term loan and Midcontinent Express Pipeline 6.7% bonds due 2019. New additions to the fund include The Stars Group 7% bonds due 2026,

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MGM Resorts 5.75% bonds due 2025, and Macquarie 6.125% perpetual preferred shares. Active share in the fund is 94%.

Our outlook is consistent with last quarter. The high-yield bond market lacks both positive and negative catalysts and is subject to broader risk sentiment. International trade costs are escalating, pushed higher by tariffs, fuel costs, and logistics bottlenecks. These factors will bite into growth just as the European Central Bank is set to end its quantitative program later this year. It is an open question whether the projected impact is sufficient for the Fed to pause on its hiking path. The Fed did express such a concern, as well as an indication that they are watching the slope of the yield curve in their June meeting minutes, released in early July. U.S. mid-term elections are around the corner, so we do not expect trade rhetoric to abate until the new year. Our intermediate-term strategy involves increasing the quality of the bond portfolio and eventually layering in some government bonds as duration risk to hedge the credit risk.

Class F Returns (in %) as at June 30, 2018	Year-to-date	1 year	3 year	5 year	10 year
Signature Corporate Bond Fund	0.8	1.7	4.0	5.2	6.3

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