Market Commentary
First Quarter 2018

Signature Dividend Fund

Equities market

Market volatility increased during the quarter, pushing equity risk premiums higher for the time being. It is difficult to accurately identify specific catalysts for the increased volatility as there are a few potential suspects, including interest-rate movements, politics around trade relationships, foreign currency movements and concerns regarding the length of the current economic expansion.

The S&P 500 Index closed the quarter 8% below its high on January 26. Bloomberg's world exchange market capitalization index ended the quarter 7.3% below its high on January 28, but was down less than half a percent over the full quarter. Domestically, the S&P/TSX Composite Index returned negative 4.5%. Emerging markets on a combined basis had a slightly positive return during the quarter. Tax cuts in the U.S. support a strong U.S. economic and market outlook while economic data from Europe continues to reassure, and emerging markets have been performing well despite a growing belief that the global rate structure is increasing. The Signature team views equity market valuations as quite reasonable with global growth indicators generally remaining encouraging.

Equities performance

The fund's equity holdings generated a negative return of 4% on a local currency basis. Negative equity performance was broad based; however, the information technology sector was the only sector with notably positive performance in the benchmark and the fund remains slightly overweight this sector. Relative stock selection was most positive in the materials and utilities sectors and most disappointing in real estate, pipelines and financials. The success in materials was led by the greater-than-25% gain in paper packaging products company Smurfit Kappa, which received an acquisition proposal from International Paper Co.

Domestically our top contributor was Sun Life – a position we trimmed materially during the quarter to lock in a better-than 5% intra-quarter gain. In contrast, Manulife was a large domestic detractor as the stock declined more than 8%. Following GE's large reserving charge on its U.S. long-term care exposure, Manulife's relative valuation has declined materially. We acknowledge and sympathize with market concerns in regard to the company's riskier legacy businesses and have always discounted our valuation estimate for this reason. Recent price weakness in regard to this seems excessive and we view Manulife as an attractive means to participate in strong Asian insurance market growth.

The largest single detractor during the quarter was Enbridge, which declined 17% in the period. Through the quarter, Enbridge fell due to market concerns around growth funding, pipeline permitting, and changes to regulatory tariffs in the U.S. We believe these concerns have been overly priced in to the shares. In the near to mid-term, expansion approvals, asset sales and further simplification of a complex corporate structure should help close the company's discount to fair value.

Preferred shares market

Canada's preferred share market had a volatile first quarter following the broader risky-assets market run-up in January and subsequent sell-off in February and March. Rising interest rates and growing concerns about a trade war, on top of high equity valuations, caused risky asset markets to fall and volatility to rise. Canada's economy continued to perform well in the first quarter which may prompt the Bank of Canada to raise rates slowly this year. Global risky assets were volatile as the S&P 500 Index fell 0.76%; however, West Texas Intermediate (WTI) crude continued to climb, rising 7% to close at $64.94 a barrel.

The BMO Capital Markets 50 Index posted a 0.54% total return for the first quarter, while the broader S&P/TSX Preferred Share Index was down 0.15%, again due to its lower weighting in floating-rate preferred shares. Within the BMO 50, floating stocks led the index for a fifth consecutive quarter with a 6.13% return. In contrast, rate reset preferred shares retuned 0.22% and perpetual preferred stocks generated -1.18%.

Supporting preferred shares was the Bank of Canada's 25-basis-point overnight rate increase to 1.25%, and 5-year Canadas, which moved 11 basis points higher to 1.97%. Preferred shares continued to benefit from strong retail demand in January; however, demand fell along with the equity sell-off. The sell-off in preferred shares from January highs was the result of higher issuance, as well as retail investors disposing of these assets after two years of strong returns, and institutional investors seeking better levels before buying.

Issuance picked up with eight issues totalling $2.075 billion. There were only three redemptions announced, totalling $420 million, for a net increase of $1.65 billion during the quarter. Issuance is expected to be manageable in 2018 but higher than in 2017 as AltaGas will likely issue to help fund its acquisition of WGL Holdings, and as Canadian banks refinance legacy additional tier-1 bonds.

The U.S. Federal Reserve raised rates by 25 basis points at its March meeting, with its "dot plot" signalling two more increases in 2018 and continued hikes in 2019. The Bank of Canada raised rates in January amid strong employment growth but also noted that ongoing NAFTA negotiations may reduce growth. Still, with Canada's unemployment rate at 5.8% for two consecutive months, the market expects further rate hikes.

Preferred shares performance
The fund's preferred shares outperformed mainly due to a high overweight of floating rate preferred shares.

Citigroup N benefited from rising Libor yields and the Fed's rate hike. In addition, fund holdings Brookfield B,K and BCE J, E benefitted from the increase in the prime rate by Canadian banks.

Security selection within the perpetual preferred sector added to performance. CU Inc. A, Power Financial R and E-L Financial G were the top-performing holdings in the perpetual sector.

The main detractor was an underweight to the fixed/floating sector and security selection within the floating rate sector.

Outlook
Our view is that equity risk premiums are quite reasonable given the strongly supportive global economic outlook. Deflation risks have likely given way to reflation risks supporting asset-class rotations that may add to investment-return volatility. Equity market returns will be primarily dependent on earnings growth and dividend payments as there is only modest room for general multiple expansion. The U.S. economic outlook remains appealing while the European region is making modest-yet-significant progress. We believe that strengthening developed economies will support bumpy, but acceptable, returns from equities relative to the rather limited investment alternatives. We have a cautious medium-term view on the Canadian economy and domestic equity markets.

The outlook for the preferred market remains positive as higher interest rates in Canada support the rate reset and floating preferred shares that make up over 80% of the market. Retail demand has waned recently, but we believe it will return and that institutional demand for preferred shares will continue due to expected better returns than fixed-income markets. Given the weak first quarter, we have lowered our annual expected returns for 2018 based on expectations of a further 25-basis-point rate hike by the Bank of Canada.

Following the recent weakness in common equity valuations relative to preferred shares we expect to opportunistically reduce the preferred share weight slightly and add to attractively priced common equity positions.

Class F Returns (in %) as at March 31, 2018	Year-to-date	1 year	3 year	5 year	10 year
Signature Dividend Fund	-1.6	4.4	4.8	7.9	7.1

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