Market Commentary
Second Quarter 2018

Signature Dividend Fund

Developed markets outperformed emerging markets for the quarter, supported by U.S. equities. The MSCI ACWI High Dividend Yield Index underperformed the broader MSCI ACWI Index with a loss of 1.3% in U.S. currency. The Canadian market was relatively strong with the S&P/TSX Composite Index returning 6.8% for the quarter, primarily supported by the energy sector.

Earlier in the year, market volatility and equity risk premiums rose and have yet to tighten. Potential suspects for the higher risk premiums include interest rate movements, politics around trade relationships, foreign currency movements and the length of the current economic expansion. We do not believe the absolute length of the current economic expansion is a prudent reason to become overly defensive. The magnitude of this expansion was very subdued relative to other recoveries and thus it is likely to continue, especially with the U.S. tax cuts supporting business sentiment. Our team views equity market valuations as reasonable with global growth indicators generally remaining encouraging.

The Canadian preferred share market was volatile during the first quarter of 2018, but improved with the rise in the five-year Government of Canada bond yield in the second quarter. Trade war concerns continued, but the equity market made slow gains as a result of strong corporate earnings and solid economic news. Global assets with more perceived risk were volatile, and the U.S. equity market, as measured by the S&P 500 Index, declined 0.8% in the first quarter, but rose 3.4% during the second. West Texas Intermediate oil prices were up, closing the period at US$74.15 per barrel.

The BMO 50 Preferred Share Index posted a 1.2% total return in the second quarter, while the broader S&P/TSX Preferred Share Index was up 0.9%. Within the BMO 50 Preferred Share Index, perpetual preferred shares led the Index, while rate reset preferred shares returned 1.3% and floating rate preferred shares, -0.4%. Supporting preferred share performance were rising Canadian interest rates and the rising five-year Government of Canada bond yield, which moved higher amid expectations that the Bank of Canada would raise interest rates by another 25 basis points (bps) in July. Trading volumes during the second quarter were lighter than normal as new issuance was low.

Issuance fell in the second quarter with three issues totalling $850 million and four redemptions announced for $550 million – a net increase of $300 million during the quarter. The new issues did not initially trade well in the secondary market. Issuance is expected to increase in the second half of 2018 as AltaGas will likely issue to help fund its WGL acquisition and as Canadian banks refinance legacy additional Tier 1 bonds.

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The U.S. Federal Reserve Board raised interest rates by 25 bps at each of its March and June meetings, and signalled two more increases in 2018 and further increases in 2019. The Bank of Canada raised interest rates in January amid strong employment growth, but kept its overnight rate on hold during the second quarter. However, the Bank of Canada signalled that it would look to remove its accommodative monetary policy as the bank rate is still below the rate of inflation.

Fund performance

Canadian equities outperformed global equities during the quarter and our security selection globally did not offset our underweight position in Canadian equities. However, we have greater late-cycle concerns for the Canadian economy than for the U.S. and European markets and will maintain our underweight in Canadian equities.

The majority of sectors achieved modestly positive performance during the quarter, led by energy. Within the fund’s equities, the relative success in energy was led by the greater than 21% gain in Encana and 18% in Canadian Natural Resources and EOG Resources. Equinor, previously called Statoil, was one of our larger positive contributors and was sold during the quarter following a 12% rally. Enbridge recovered more than 17% during the quarter and was our largest single contributor to positive performance. Note, however, that in the previous quarter, Enbridge declined 17% and was the fund’s largest single detractor. As political and regulatory approvals progress, we expect Enbridge’s valuation to continue recovering.

The largest individual detractor during the quarter was Taiwan Semiconductor which declined 13.3%. During the quarter we modestly reduced exposure to semiconductor companies on trade war concerns.

In the fund’s preferred shares component, the main contributor to performance was positive security selection and a significant exposure to floating rate preferred shares. Citigroup N benefited from rising Libor yields and the Federal Open Market Committee (FOMC) interest rate hike while holdings of BNS C benefitted from rising T bill rates and BMO R was announced for redemption. The main detractor was an underweight to the fixed and floating rate preferred share sector and security selection within the sector. The main individual detractor was a large holding of BCE A that returned -2.9% over the quarter.

Outlook

Our view is that equity risk premiums are reasonably attractive given the somewhat supportive global economic outlook, although potentially increasing trade friction is a risk that needs to be continually assessed. 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 yet 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.

Looking forward, the outlook for the preferred share market remains positive as higher interest rates in Canada should support the rate reset and floating rate preferred shares that make up the majority of the market. North American Free Trade Agreement negotiations, U.S. tariffs on aluminum and global trade war rhetoric are having a negative impact on the Canadian economy and thus, should moderate further interest rate increases.

Class F Returns (in %) as at June 30, 2018	Year-to-date	1 year	3 year	5 year	10 year
Signature Dividend Fund	-0.1	6.1	6.0	8.3	7.5