Market Commentary
Third Quarter 2018

SIGNATURE GLOBAL ASSET MANAGEMENT™

Signature Emerging Markets Fund

The selling pressure on emerging markets continued into the third quarter of 2018, with equities at one point down just more than 20% compared to the late-January 2018 highs. Ignoring the high of January and despite a recovery during the second half of September, emerging market equities were still down 7.5% during the first nine months of the year, significantly underperforming developed market equities, which recorded a gain of 3.8% over the same period. The fact that the decline in the third quarter occurred despite a broadly unchanged U.S. dollar emphasized the importance of tighter global financial conditions on emerging market assets rather than simply U.S. dollar strength. Higher U.S. interest rates, higher oil prices, ongoing concerns about Argentina and Turkey, and increased worries about the Chinese economy continued to weigh on emerging market assets. Rising trade tension between the U.S. and China added to the already cautious stance.

We continue to believe this is not the time to rely on arguments centring on positioning, underperformance or valuation to justify buying into emerging markets. Although these arguments carry some weight, the ultimate outcome of emerging market returns over the next few months and quarters will most likely be driven by other factors.

Even though global growth is expected to remain healthy (albeit slightly lower than in 2017), the continued tightening of financial conditions will remain a key overhang on emerging markets. Not only will rising U.S. rates adversely impact emerging markets, but the quantitative easing program by the European Central Bank grinds to a halt by the end of the year and the Bank of Japan has already indicated that it is in favour of slightly higher rates. Thus, for the first time in almost 10 years, major central banks will either be tightening or remain neutral – not easing – increasing the chances of tighter financial conditions throughout 2019. Our constructive view on oil prices, a slowing Chinese economy, and policy uncertainties across a number of emerging market economies (Turkey, Brazil, Mexico, South Africa, India, and China) leaves us cautious on emerging market assets in the near term. A sharper slowdown in China or higher-than-expected inflation in the U.S. are two key risks to the downside, although we see both scenarios as risks and not the base case.

On the other hand, strong and fairly stable global growth, healthy banking systems across most emerging markets (China being the most obvious exception), robust government debt (India, Brazil, and Hungary being the exceptions), and credible domestic monetary policy in a majority of the countries provide strong counter-arguments to becoming too bearish on emerging markets over the medium term.

We prefer a more defensively positioned portfolio as we enter the fourth quarter. We reduced our exposure to the technology sector, maintain a low exposure to discretionary spending and real estate and are more constructively positioned in banks, energy, and utilities.

2 Queen Street East, Twentieth Floor, Toronto, Ontario M5C 3G7 | **www.ci.com**

CI Investments

Head Office / Toronto	**Calgary**	**Montreal**	**Vancouver**	**Client Services**
416-364-1145	403-205-4396	514-875-0090	604-681-3346	English: 1-800-563-5181
1-800-268-9374	1-800-776-9027	1-800-268-1602	1-800-665-6994	French: 1-800-668-3528

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Class F Returns (in %) as at September 30, 2018	Year-to-date	1 year	3 year	5 year	10 year
Signature Emerging Markets Fund	-5.1	1.7	9.8	6.6	5.9

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