Market Commentary
Second Quarter 2018

Signature Global Bond Fund

The pickup in volatility in capital markets that we witnessed in the first quarter of 2018 continued in the second quarter as geopolitical uncertainty led markets to reprice risk premia globally. A contributor to volatility was the escalation in trade war rhetoric that ultimately materialized into action as the U.S. levied aluminum and steel tariffs against its trading partners including China, Japan, the European Union, and Canada.

Against this backdrop growth in the U.S. remained robust, enabling the U.S. Federal Reserve (Fed) to continue tightening monetary policy by raising interest rates for a second time this year at its June meetings. As U.S. monetary policy continued to diverge from the rest of the world and put pressure on the global cost of capital, U.S. corporate bond spreads and emerging market bond spreads steadily widened. Despite these developments, the Fed signalled intentions to raise interest rates two more times before the end of the year. Clearly, the hurdle for the Fed to cease hiking is significantly higher than in 2013 (with the taper tantrum) or in 2016 (with the deflation scare).

The Bank of Canada has remained on hold after hiking interest rates in January to 1.25%. A combination of mixed economic data throughout the second quarter as well as business uncertainty induced by NAFTA re-negotiations persuaded the Bank of Canada to proceed with caution in its hiking cycle. Elsewhere, a new populist government in Italy renewed concerns about the stability and integrity of the European Union and led to a blowout in Italian government bond spreads (to German government bonds). Despite higher political risks and a noticeable slowdown in growth momentum in the European Union, the European Central Bank (ECB) revised its inflation forecast higher and announced its intentions to wind down quantitative easing at the end of 2018. However, it introduced forward guidance and set expectations that interest rates would remain at current levels until at least the summer of next year. In the U.K., the Bank of England has been on hold year-to-date as economic data have significantly missed official forecasts and Brexit negotiations effectively stalled amid political wrangling within the U.K. parliament.

The response across global bond markets saw 10-year interest rates in Canada and the U.S. rise in the second quarter to 2.86% and 2.17%, respectively. However, over the same period, 10-year interest rates fell in Germany and the U.K. to 0.3% and 1.28%, respectively.

Signature Global Bond Fund returned -1.9% during the second quarter of 2018. The negative return was largely attributed to currency as the Canadian dollar was one of the best performing currencies among G10 countries in the second quarter.

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Allocations to U.S. agency mortgage-backed securities and U.S. treasury inflation-protected bonds contributed to performance as did an underweight exposure to Italian government bonds and an overweight Canadian currency exposure at the expense of euro and Japanese yen currency exposures. However, the fund's allocation to U.S. dollar-denominated emerging market sovereign bonds detracted.

At the end of the first quarter of 2018, the fund had an allocation of approximately 25% to U.S. dollar emerging market sovereign debt. As a stronger U.S. dollar and higher U.S. interest rates put significant pressure on emerging market spreads, we decreased exposure to emerging market sovereigns to approximately 10% of the fund by the end of the second quarter. Furthermore, as the trade war rhetoric between the U.S. and its trade partners escalated we maintained exposure to U.S. inflation-linked bonds at approximately 8.2%.

From a duration perspective, the renewed political uncertainty throughout the second quarter in Europe resulted in our decision to extend European duration by selling shorter dated Spanish and Italian government bonds to buy longer dated French and German government bonds. In addition, as the balance of risks have shifted further to the downside, we maintained an underweight in euro currency exposure relative to the benchmark but shifted to neutral Japanese yen currency exposure relative to the benchmark. However, with respect to Japanese yen duration exposure, the fund remained underweight in favour of higher income-generating Canadian and U.S. dollar-denominated bonds.

Over the medium term, higher global trade barriers and the emergence of populist politics and policies could result in a buildup of inflationary pressures. This increases risks of monetary policy errors if central banks are perceived to fall behind the curve, so we remain constructive on inflation-linked bonds.

In the near term, we continue to monitor developments in global trade wars although we would note that global growth remains constructive. Until there is more clarity on trade negotiations for NAFTA, Brexit, and U.S.-China, we expect volatility to remain elevated and note that the probability of downside risks across global capital markets has risen. Therefore, we stand ready to manage these risks in the portfolio by adding duration (interest rate exposure) and/or reducing exposure to spread risk premia.

Class F Returns (in %) as at June 30, 2018	Year-to-date	1 year	3 year	5 year	10 year
Signature Global Bond Fund	0.7	-0.1	2.7	4.2	4.8

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