Market Commentary
Third Quarter 2018

Signature Global Bond Fund

After a volatile first half of 2018 during which the risk premium was repriced globally, risk assets found some reprieve at the beginning of the third quarter. However, the persistence of U.S.-China trade tensions and continued tightening of global financial conditions triggered another bout of volatility, particularly in emerging markets.

In developed markets, economic activity remains on track but has become increasingly tilted toward the U.S. Indeed, solid U.S. economic performance has been a dominant driver of global financial markets in recent months, strengthening the U.S. dollar against most major currencies (with the notable exception of the Canadian dollar) and causing U.S. interest rates to rise. U.S. economic developments are in line with the U.S. Federal Reserve's projections, creating a high hurdle for the Fed to relent – or even pause – on its current path of tightening monetary policy.

In Canada, the Bank of Canada (BoC) hiked interest rates in July, the second time this year, to 1.5%. While economic data have evolved broadly in line with BoC forecasts, business uncertainty induced by the NAFTA (now U.S.-Mexico-Canada Agreement, or USMCA) re-negotiations has led the BoC to proceed with caution in its rate-hiking cycle, keeping rates unchanged at its September meeting. However, the resolution of trade negotiations with the U.S. and Mexico removed what was arguably the single greatest risk to the BoC policy rate path.

In Europe, the populist Italian government will continue to cause grief for the European Union (E.U.) with its recent announcement of a 2.4% budget deficit for 2019. While this figure meets the E.U.'s Stability and Growth Pact of not running a budget deficit in excess of 3%, the E.U. will likely push back given the previous Italian government's commitment to shrink the budget deficit.

Against this backdrop, global bond markets saw interest rates rise across developed markets. In North America, 10-year rates in Canada and the U.S. ended the third quarter at 2.43% and 3.06%, respectively, while in Europe, 10-year rates reached 0.47% in Germany and 1.57% in the U.K.

The Signature Global Bond Fund (Class F) returned -2.93% for the third quarter of 2018. The negative total return for the fund was largely attributed to currency as the Canadian dollar was one of the best performing currencies among G10 countries in the third quarter.

The fund was overweight in Canadian currency exposure at the expense of euro and Japanese yen currency exposures, which added roughly 0.16% to alpha. However, the fund's overweight positioning in U.S. duration and net U.S. dollar currency exposure, respectively detracted approximately -0.11% and -0.02% from alpha. The fund has a modest exposure to U.S. dollar-denominated emerging markets bonds, but does not own the vulnerable issuers such as Argentina and Turkey.

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Despite 2-year U.S. Treasuries currently yielding around 2.8% and a continued unwinding of the balance sheet (i.e. selling down bonds) by the Fed, financial conditions remain modestly accommodative.

As the divergence between U.S. rates and the rest of the world grows, the U.S. dollar could continue to strengthen in the short-term, which means that vulnerable emerging market economies (with large U.S. dollar-denominated debt) should continue to import the Fed's monetary policy tightening.

The fund's alpha exposure to euro-denominated assets remains underweight, as does its alpha exposure to Italy.

The expected showdown between the E.U. and the Italian government over the latter's budget deficit proposal will likely keep volatility high in Europe and put downward pressure on the euro and Italian spreads.

The fund recently added a 2% allocation to U.S. investment-grade corporate bonds by selling duration-equivalent U.S. Treasury bonds.

At the start of 2018, we maintained that U.S. investment-grade spreads (to Treasuries) should widen and they did (almost 30 basis points). Recently, our analysis indicated that dynamics surrounding investor demand and issuer supply, coupled with strong corporate earnings, could lead to a tightening in corporate spreads in the near term.

Outlook
In the near term, we expect positive economic momentum in the U.S. to continue, which would be supportive of credit spreads in this market. This should also enable the Fed to continue tightening monetary policy by raising interest rates so we expect that short-term interest rates will continue to rise in the U.S.

In the medium term, we continue to closely monitor inflation dynamics in the U.S., as additional wage pressures or further escalation of the U.S.-China trade war could put upward pressure on inflation expectations. Such a scenario could force the Fed to raise interest rates faster than has been currently communicated to the market.

While financial conditions have become less accommodative globally, the speed at which the Fed is normalizing monetary policy is outpacing other developed market central banks. A growing divergence between U.S. rates and the rest of the world could continue strengthening the U.S. dollar. A sharp tightening of global financial conditions could lead investors to shed risky assets.

In the geopolitical sphere, we continue to monitor developments in the U.S.-China relationship and the ongoing Brexit negotiations.

Although the growth outlook remains constructive in major economies, particularly in the U.S., we note downside risks as global markets adjust to the reversal of accommodative financial conditions, which have

been in place for the last decade. As such, we stand ready to manage these risks in the portfolio by adding duration (interest rate exposure) and/or reducing exposure to credit spreads.

Class F Returns (in %) as at September 30, 2018	Year-to-date	1 year	3 year	5 year	10 year
Signature Global Bond Fund	-2.7	-1.2	-1.1	3.6	4.5

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