Market Commentary
Fourth Quarter 2017

Signature Global Bond Fund

The year (2017) began with geopolitical tensions, concerns about trade protectionism and the risk of the far right dominating European politics. The consensus expectations of a pick-up in wage growth, higher inflation, a stronger U.S. dollar and 10-year U.S. rates at 3% didn't materialize within the year. Instead, momentum trades, low volatility, tighter spreads and tax reform legislation in the U.S. were among the main stories for credit markets in 2017.

Despite the hawkish tone of central bankers across the developed world, global financial conditions remained supportive and risk assets continue to outperform. This may have given the U.S. Federal Reserve (Fed) the confidence to continue its tightening path and policy makers reiterated their support for a gradual approach to raising interest rates. Even after three rate hikes and the initiation of balance sheet normalization by the Fed, the 10-year U.S. rate ended the year at 2.46%. Weak inflation expectations only nudged up moderately in the fourth quarter, which helped keep rates range bound in 2017.

The Bank of Canada raised rates twice in 2017 and remained concerned about valuations in the housing market and elevated household debt, which makes the economy more sensitive to higher future interest rates. The 10-year Canadian interest rate declined 0.07% in the fourth quarter, ending the year at 2.04%. This represents a 0.36% increase from the 2017 starting level.

Elsewhere, the European Central Bank ended 2017 on an optimistic note, raising growth forecasts for the next two years. However, underlying inflation in Europe, as well as in Japan, continues to fall short of central bank targets. Furthermore, the Bank of England took back the post-referendum emergency interest rate cut and hiked interest rates 0.25% as inflation in the U.K reached a five-year high.

As developed markets started seeing rate hikes, some of the emerging economies facing low inflation, such as Brazil and Indonesia, cut rates in 2017 to stimulate economic growth. However, in Mexico, despite the North American Free Trade Agreement (NAFTA) overhang, the central bank tightened five times in 2017 to counter inflation that hit a 16-year high.

Performance

The Signature Global Bond portfolio returned 1.62% in the fourth quarter. The total return of the portfolio was primarily driven by a continued outperformance of global credit risk premia. Yield-curve positioning added to alpha as an overweight in Canadian dollar-denominated duration benefitted from the fall in long-term Canadian interest rates throughout the quarter. However,

currency positioning detracted from alpha. This was due to the strategy's overweight in Canadian dollar-denominated debt and underweight in euro-denominated debt, as the Canadian dollar depreciated relative to most of its G10 peers. In contrast, the euro was the best performing G10 currency throughout the last quarter of 2017. In spread space, exposure to Canadian dollar-denominated provincial government bonds, U.S. agency mortgages, U.S. Treasury Inflation Protected Securities (TIPS) and U.S. dollar-denominated emerging market (EM) sovereign bonds combined to contribute to alpha.

Positioning: Duration, curve, spreads and currencies

The portfolio remains underweight total duration relative to the benchmark, primarily concentrated in the long end of the European and Japanese yield curves. In terms of currency exposure, the strategy remains underweight in Japanese yen and euro-denominated bonds in favour of an overweight in higher-income generating Canadian dollar-denominated bonds. However, the underweight exposure to euro debt was reduced at the expense of U.S. dollar-denominated government and agency debt.

Additionally, we continued to increase the portfolio's exposure to U.S. dollar-denominated EM sovereigns throughout the fourth quarter, ending the year with roughly 15% of the portfolio invested in this asset class. Lastly, we increased the exposure to TIPS from roughly 1.6% at the end of the third quarter to 3.6% at the end of the year.

Outlook: Structural shifts are challenging but cyclical turns are a certainty

Policy interest rates in the U.S. and Canada are expected to rise gradually in 2018. Markets have currently priced in four rate hikes for Canada and two for the U.S. over the coming year. Global growth continues to be strong, but weak inflation will put central banks to the test especially if the Fed tightens monetary policy too quickly. It also remains to be seen how Fed policy will change, if at all, under Jerome Powell, the new chairman of the Fed starting in February 2018.

A number of downside risks persist. These include missteps by the current U.S. administration, a correction in asset valuations, international trade concerns amid NAFTA's renegotiation and ever-changing U.S. trade policy. Elections in multiple EM countries such as Mexico, Brazil and Colombia, could give rise to idiosyncratic risks and create opportunities.

The yield curve in the U.S. is the flattest it has been since the Great Financial Crisis, and we remain cautious in positioning our portfolios as the bond market begins to signal a decline in growth expectations.

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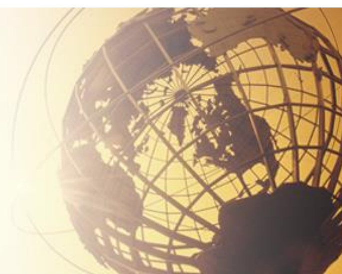

Class F Returns (in %) as at December 31, 2017	Year-to-date	1 year	3 year	5 year	10 year
Signature Global Bond Fund	-0.9	-0.9	3.9	4.0	5.5

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