Market Commentary
First Quarter 2018

Signature High Yield Bond II Fund

Broad market performance across ratings was commensurate with credit risk (e.g. CCCs outperforming Bs; BBs outperforming BBBs, etc.) which would be expected in a spread-tightening environment. However, in the first quarter it was correlated with duration as the U.S. yield structure increased despite equity volatility. Typically, duration falls in sync with credit ratings but the first quarter was anything but typical. Cross-asset correlations and volatility spiked (i.e. portfolio diversification failed) as U.S. government bond yields moved higher. Whether it was increased T-Bill supply on larger budget deficits, front-end corporate bond selling as U.S. companies repatriated foreign profits, or increased funding costs causing leveraged carry trade unwinds, there were few places to hide. The spread on the ICE BofAML U.S. High Yield Index increased 11 basis points (to +382 basis points from +373 basis points) although the all-in yield increased 51 basis points to 6.35%.

Performance

In the first quarter of 2018, the fund returned 0.1%. A key contributor to performance was Getty Images; we own the 7% bonds due 2020, and the L+350 term loan due 2019. Getty Images is a global leader in stock photography and digital images. The debt securities, previously trading well below par, rallied as the prospect of early refinancing gained steam with investors.

From an asset-allocation perspective, the fund's weighting in loans added relative value as that asset class strengthened on the gain in three-month U.S. Libor, which climbed to 2.31% from 1.69% during the quarter. Financial fixed-floating preferreds have been a long-term trade for us as the global banks repair their balance sheets. In 2018 to date, this asset class has been strongly correlated with high yield as investors have been utilizing the better liquidity in this sub-asset class to rotate into equities. This is in contrast to 2015 when high-yield bond spreads widened with economic and commodity price softness but bank preferred held their value. Also contributing positively was currency as the 95% of fund assets denominated in U.S. dollars were hedged to 80%, leaving approximately 25% of the fund effectively exposed to the gain in the greenback.

Detractors from performance

Detracting from relative performance was our position in Teck Resources 6% bonds of 2040. While the U.S. yield curve flattened significantly in the quarter, the long-end ended 23 basis points higher. This was enough to cause a price drop in long-dated corporate bonds. We view Teck Resources as a near-term upgraded candidate to investment-grade and believe the ensuing spread compression will more than mitigate any further increases in long-term rates.

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Positioning

The fund finished the quarter with approximately 3% in cash. Over the quarter, the fund's average credit quality remained steady at BB-.

We added a new position in Boyne Resorts 7.25% bonds due 2025. Boyne is the owner and operator of ski resorts in Canada and the U.S., including Cypress Mountain, located just outside of Vancouver. Our previous experience in the term loan of Intrawest and the equity of Whistler-Blackcomb gave us additional confidence in the cash flow characteristics and asset value of the business model. Also new in the portfolio was the Canadian dollar-denominated 6.5% bonds due 2023 from Nuvista Energy. Nuvista is a Montney-focused oil and gas producer where the bulk of earnings are from condensate (priced at a premium to West Texas Intermediate) used as diluent in the oil sands. Since its products are used within Alberta, Nuvista isn't encumbered by right of egress issues, not does it suffer from poor pricing differentials like many other energy producers.

Outlook

Our base case for the remainder of 2018 suggests modest spread tightening sufficient to drive positive full-year returns unless inflation data forces the U.S. Federal Reserve to a more aggressive hiking path. Falling equity market volatility would make this easier as no asset class is an island in itself. In that vein, we see high-yield bonds lacking catalysts – positive or negative. High-yield bond credit risk, valuations and sentiment are neither in the polar region nor the tropics, therefore subject to the trade winds of larger asset classes. And that is not a coincidental choice of words, as trade policy and the escalating rhetoric between the U.S. and China is a risk to growth in 2018.

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Class F Returns (in %) as at March 31, 2018	Year-to-date	1 year	3 year	5 year	10 year	Since inception	Inception date
Signature High Yield Bond II Fund	0.1	3.3	5.0	N/A	N/A	6.8	8/31/2013

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