Market Commentary
Third Quarter 2018

Signature High Yield Bond II Fund

Where the first half of 2018 was volatile, summer found a bid for risky assets. However, the onward march of U.S. interest rates and growing U.S.-China trade and political tensions triggered another bout of volatility late in the third quarter. Economic strength in the U.S. has been the dominant driver of financial markets this year and dollar strength is starting to impair the credit quality of emerging market sovereigns and corporates. Developed market corporate bond issuers are less affected and still seen as beneficiaries of U.S. tax cuts. Corporate bond spreads were largely rangebound over the quarter. More interesting moves were witnessed in Italy as sovereign yields widened on the new populist government's announcement of a 2.4% budget deficit, incongruent with earlier pledges.

Over the course of the quarter, high-yield bond spreads tightened 44 basis points to +338 basis points, effectively absorbing the impact of higher underlying government bond yields. Investment-grade bond spreads continued to widen through the spring, before finishing the quarter four basis points tighter to +112 basis points, with Canadian bonds less volatile than the U.S. market.

The defensive positioning that helped us earlier in the year worked against us at the margin during the quarter. Offsetting this, developments in the Western Canadian energy patch had a positive effect on performance. Investment-grade rated Husky Energy's hostile bid for lower-rated MEG Energy saw those bonds trade materially higher. Baytex Energy's acquisition of lower-levered Raging River Exploration set Baytex up for credit ratings upgrades. Also material to Western Canada was the decision by Royal Dutch Shell and its consortium partners to proceed with their LNG export facility in B.C. This should support natural gas prices, and by extension, the many oil producers who produce associate gas.

The term loans of DHX Media and Digicert were sold. Re-pricings in that market are providing us a cost-effective opportunity to gradually reduce exposure. The US Foods 5.875% bonds due 2024 were re-added to the fund. We also materially added to our position in New Gold bonds on recent weakness. Our thesis on this gold producer, as with select copper producers like First Quantum Minerals, another material position, is that years of underinvestment in mining has set the stage for supply deficits in coming years, making the industry ripe for consolidation.

The yield difference between the U.S. 10-year Treasury bond and the 10-year German bond sat at a then-record of 2.6% at the end of the third quarter. Should the European Central Bank begin hiking interest rates this time next year and the Bank of Japan raise rates to zero under the auspices of a new, more hawkish Governor next year, there is a risk that U.S. bond yields will become unanchored and break out of their current channel. In this case, higher yields, with the impact of tariffs, will

begin to bite the consumer and corporations and bring the current prolonged economic expansion to an end (although that is not our base case). Our base case assumes U.S.-centric growth persists and earnings growth moderates but stays positive. In this environment, we believe that equities should outperform fixed income, and credit should outperform duration.

A bout of volatility, or policy uncertainty, could be healthy if it tames the animal spirits in the markets. Until then many markets, corporate bonds included, lack identifiable positive or negative catalysts and will be subject to broader risk sentiment. Merger and acquisition activities will continue and generally be credit negative for investment-grade issuers and positive for high-yield companies. Investors looking for a market turn signal from the high-yield bond market, traditionally reliable as the "canary in the coal mine," may be disappointed. Credit quality is relatively high, issuance is low, and outflows are ongoing, in stark contrast to the emerging market bond, investment-grade bond, and leverage loan markets. Cognizant that deterioration in those markets will pressure our core markets, we are gradually de-risking the fund.

Class F Returns (in %) as at Septebmer 30, 2018	Year-to-date	1 year	3 year	5 year	Since inception (7/30/2013)
Signature High Yield Bond II Fund	3.3	4.1	7.3	6.7	6.6

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