

# Market Commentary

## Third Quarter 2018



### Signature Income & Growth Fund

The S&P/TSX Composite Index was one of the weaker stock markets globally in Q3, on account of weakness in energy, as oil prices corrected, and materials. Even Canadian banks were weak, while industrials was one of the better performing sectors. Interestingly, the weakness in these two cyclical sectors does not suggest a global economic slowdown. In fact, economic data continues to confirm the continuation of a global synchronized recovery as European economies in particular continue to improve.

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 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.

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.

Leading performers included Shopify, the Canadian cloud-based commerce platform, and Alibaba, the largest Chinese e-commerce platform.

Materials also contributed marginally thanks to companies like Lundin Mining and Tahoe Resources.

Energy performance was weak, with companies like Encana detracting as they were caught in the oil price decline. Energy weakened through most of the quarter as oil inventories, which were declining, reversed as U.S. shale production rebounded. In the last week of the quarter, oil and energy in general rebounded.

We generally remain bullish on risky assets and equities in particular. During the quarter, exposure to technology was increased slightly.

Duration and yield curve positioning added to portfolio alpha, stemming from our moderate duration position in longer maturity Canadian bonds. The Government of Canada 10-year bond yield rose by some 26 basis points over the quarter. Corporate credit exposure was also alpha accretive, as spreads narrowed five basis points in this sector among the 10-year and shorter maturities during the reporting period.

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 SIGNATURE  
GLOBAL ASSET MANAGEMENT

U.S. dollar exposure net of hedges was a slight drag on alpha, due to the U.S. dollar slipping lower against the Canadian dollar in the quarter. Portfolio foreign currency positions are actively managed through a hedging overlay.

Portfolio duration is moderately short, featuring a low exposure in the 10-year to 20-year portion of the yield curve. Provincial bonds are used to manage much of this yield curve position, while collecting better income. In the spread product sphere, we have a modest exposure to corporate credit, low exposure to Canadian government agency debt, and retain small long positions in U.S. inflation-linked bonds.

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.

Markets also appear to be transitioning from growth back to more value-oriented sectors. Technology has been a strong performer since the beginning of the year, while global financials and health care have stalled. Recent market moves suggest this may be reversing.

Our outlook for equity markets continues to be positive on account of easy financial conditions, which remain intact despite higher short-term U.S. interest rates and statements from a number of central banks on the prospect of tightening monetary conditions via higher interest rates. This can be explained by the continued global synchronized recovery, which has accelerated in Europe in particular and continued in emerging markets. Central banks like the Bank of Canada, Bank of England, and European Central Bank are making the case for more normalized monetary policy (higher interest rates). In addition, the U.S. Federal Reserve has declared that it will begin reducing the size of its balance sheet. We will be closely monitoring the impact of these developments on financial conditions.

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.

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<b>Class F Returns (in %) as at September 30, 2018</b>	<b>Year-to- date</b>	<b>1 year</b>	<b>3 year</b>	<b>5 year</b>	<b>10 year</b>
Signature Income & Growth Fund	1.8	6.4	7.4	7.5	7.7

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*Published October 2018.*