

Market Commentary



**CI Digital Roadshow – Summary of a presentation on global investing by
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Signature Global Asset Management
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Eric Bushell – Global overview

- A year ago, the Signature funds were emphasizing investments outside of Canada, as we expected Canadian equities to underperform for a third year. Low bond yields resulting from quantitative easing (QE) in the U.S. were creating asset price distortions, particularly in emerging market debt, as investors scrambled for yield. By May 2013, asset bubbles had formed in credit and the emerging markets as QE suppressed rates and volatility.
- U.S. government bond yields rose rapidly from 1.5% to about 3% in the summer of 2013 with suggestions that the Fed would begin to scale back QE (“taper talk”). This led to an exodus of capital from emerging markets, pushing rates up and currencies down. The exception was China, which was supported by internal capital reserves. We believed further increases would be small and come slowly because the global economy’s “fragility cocktail” of low growth and high leverage could not tolerate higher rates. The decade of emerging market credit expansion was over and lower growth lay ahead.
- We also believed that Europe’s poor demographics, low growth and low inflation were dangerous and that sovereign debt restructuring was absolutely necessary for the region to recover. Although equity valuations had normalized, Signature saw continued tail risks in the fall of 2013 and kept cash levels elevated in its portfolios. This cash drag weighed on performance throughout the latter part of the year as European debt and equity markets rallied.
- Tail risks have now receded. The U.S. government’s fiscal cliff has passed and the new budget has minimized the effect of spending cuts, allowing for better U.S. growth projections. Banks and governments in the European Union have seen borrowing costs fall sharply, as the European Central Bank’s pledges to backstop their debt has calmed lenders. Chinese policymakers appear determined to reduce risk in the banking system and at the local government level, despite higher interest rates. Financial regulators are softening new rules to ensure easy financial conditions. And global inflation fell in the latter half of 2013, reducing the risk of higher interest rates as the U.S. government withdraws quantitative easing.
- The U.S. appears to be entering the next phase of its recovery, with improved confidence, balance sheet strength and capital returned to shareholders. Investors have an appetite for growth, so we expect to see more capital investment in areas such as research and development, sales, mergers and acquisitions after years of underinvestment.
- Bonds remain unattractive relative to equities but still represent a deflation hedge. Stock valuations have normalized and reasonable returns can be expected in the 8-10% range based on earnings growth and dividends as opposed to further multiple expansion.

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- We are reducing cash in our global portfolios with an emphasis on cyclical stocks. We see opportunities among automotive manufacturers and parts producers, luxury goods companies, civil aerospace suppliers, and mature technology companies benefiting from a renewal cycle. We are maintaining our overweight in health care where reorganization activity and product pipelines remain strong. We are underweight energy, materials and financials. We see little value in media and utilities stocks.
- From a regional perspective, we prefer the U.S. market, which is being driven more by fundamentals, as opposed to Europe and Japan, which are still very influenced by monetary policy. We expect to find opportunities in emerging markets during 2014 as they adjust to the gradual withdrawal of QE.
- Signature Global Income & Growth Fund represents a balanced approach to the current market, offering the benefit of Signature's global equity expertise in about 60% of the fund, exposure to high-yield debt at 15%, investment-grade debt, government bonds and active currency hedging.

John Hadwen – Global financials and dividend-paying equities

- Valuations for global financial companies have normalized as they rebuilt capital, with returns in the 50% range in 2012 and 30% in 2013. Much of the regulatory uncertainty for the sector has dissipated, providing investors with greater confidence. U.S. financials should now support the economy with greater lending competition, while stress tests for European financials should help to clean up lingering issues.
- Signature Global Dividend Fund performed well in 2013, with stock selection outperforming the benchmark. A high cash weighting due to our concerns about risks in Europe, however, was a drag on performance.
- Equity valuations have risen and the spread between earnings yields and bond yields has narrowed, but risks have also receded. Returns in 2013 should be in line with earnings and dividends. Several fund holdings, including Pepsi and Coca-Cola, still offer dividend yields (at about 3%) that are higher than their bond yields (at 2%).
- Multiples for higher-yielding stocks will compress as rates rise, but Signature Global Dividend is focused on companies with strong free cash flow that can continue to increase their dividends, making them less sensitive to higher rates.

Matthew Strauss – Emerging markets

- Emerging markets (EM) were challenged in 2013, falling sharply in the summer after the U.S. Fed's taper talk raised fears of a higher U.S. dollar and interest rates. They then recovered about 15% and finished the year down 2.4% in U.S. dollar terms, showing that although volatile, emerging markets should not be dismissed as a source of returns.
- The International Monetary Fund predicts higher growth of 5.1% for emerging economies in 2014, versus 2.2% in developed markets. Performance will likely be varied by country and sector, requiring a more active stock selection process.
- Because credit expansion has run its course in many EM countries, they are going through a period of balance sheet repair and debt reduction. Those countries dependent on foreign capital such as Turkey, Indonesia, India, Brazil and South Africa are more vulnerable to shocks related to the withdrawal of QE.
- Further declines in global commodity prices are expected to be mild, which is favourable for EM. The advance in developed markets should be positive for exporters like Taiwan, Korea and Malaysia.

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- China is going through a difficult deleveraging and rebalancing period, but Signature believes the country's high savings rate and government cash reserves will smooth this adjustment. Elsewhere, political risks in countries such as Turkey and India will also have an effect on results.
- Our EM holdings are underweight materials, energy and telecommunications and overweight consumer discretionary, financials and health care.

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