Market Commentary

SIGNATURE GLOBAL ASSET MANAGEMENT™

CI Digital Roadshow – Summary of a presentation on income investing by
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Paul Simon – Government bonds and interest rates

- Consensus forecasts for U.S. growth in 2014 are bullish, based on momentum, signs of increased consumer confidence and structural improvements in sectors such as energy and technology. Several risks that had earlier threatened growth, such as the U.S. government's budget impasse and Europe's sovereign debt issues, have dissipated.
- Treasury markets now seem better balanced and prepared for the gradual withdrawal of quantitative easing. Market watchers and economists expect a steady rise in U.S. 10-year government bond yields to about 3.5% by the end of 2014.
- Signature sees some unappreciated risks in the forecast. Financing costs related to the large U.S. debt amassed over the past few years will contribute to budget deficits that are unsustainable over the long term. Disinflation is another serious concern. In order for the current acceleration in growth to be sustainable, growth must be more balanced, with more hiring and capital expenditures from the corporate sector.
- We expect a coupon-like return of about 2.5% for our U.S. government bond portfolio and 1.7% for Canadian government bonds in 2014. We remain underweight government bonds across the Signature fixed-income and balanced portfolios as we see better risk/reward opportunities in other securities.

John Shaw – Investment-grade bonds

- Investment-grade corporate bonds outperformed Canadian government bonds by more than 300 basis points in 2013. We expect their outperformance to be lower in 2014 because of the higher starting valuations and because spreads have narrowed.
- Fundamental credit conditions are favourable with slowly growing corporate earnings and some sectors continuing to deleverage, but at a reduced rate. The new issue calendar is shrinking but demand remains strong as investors seek higher yields. We believe spreads over government bonds are now fair.
- Risks include higher debt loads for some borrowers as a result of increased merger and acquisition activity, or borrowing for non-accretive purposes such as Tim Hortons' move to borrow $900 million to buy back stock. The high level of demand is also translating into poorly priced or structured issues.
- Overall, the Signature portfolios are overweight investment-grade corporate bonds over government bonds. Within investment grade, we are overweight foreign bank bonds, where spreads have been wider,

and underweight Canadian bank bonds. We are also overweight Canadian REIT and first mortgage bonds, where we see improving credit quality and attractive spreads. The Signature funds are underweight utility bonds, where spreads are very narrow at the long end of the spectrum due to strong investor demand.

Geof Marshall – High-yield bonds

- High-yield corporate bonds have been in a long rally since the lows of 2009 and although spreads have compressed dramatically, we believe there is a bit more to go.
- High-yield bonds returned 7.4% in 2013. The market was strong through the spring, and Signature sold several positions during this rally. High-yield bond prices dropped about 2.5 points and spreads widened following the Fed's "taper talk" in early May. Although government bond prices continued to drift lower through to the end of the year, high-yield bond valuations began to improve in the fall. We expect this dynamic to continue in 2014, with the spread component of high-yield bond yields acting as a "shock absorber" for gradually rising government bond interest rates.
- High-yield valuations are rich and likely to become richer. We expect the asset class to lead fixed income again in 2014, with returns in the mid-single digits and slightly below last year. Credit quality remains stable, and defaults should remain in the 2% range. High investor demand and low supply, past equity market volatility and relatively low rates should also continue to support high-yield valuations.
- Risks include credit quality deterioration in the new issue market (this tends to occur later in the credit cycle), especially with leveraged loans. We will monitor this and upgrade the credit quality of the Signature high-yield portfolio as needed.
- We expect to see well-priced opportunities with some new issuers, bonds from companies participating in mergers and acquisitions, and in the metals and materials sectors. At a portfolio level, while high-yield bonds no longer provide the same value as a substitute for equity investments, they still provide a diversification benefit with income, low volatility and less interest rate risk than other fixed-income asset classes.

Ryan Fitzgerald – High-yielding equities

- In the fall of 2012, structurally low interest rates had driven valuations for many higher-yielding equities to extreme levels. As a result, we invested in a number of "traditional" dividend-paying stocks for Signature Diversified Yield Fund, Signature Diversified Yield II Fund and Signature High Income Fund.
- In the Signature Diversified Yield portfolios, we invested in consumer staples, health care and financials stocks, and Canadian bank stocks in Signature High Income Fund. Equity markets have since rallied strongly and valuations for many of the funds' core higher-yielding investments fell sharply after the Fed's discussion that it would reduce quantitative easing. So we are selling the funds' traditional equity positions and have begun to reinvest the proceeds.
- A gradual rise in U.S. 10-year bond yields to about 3.5% in 2014 and 4% by the end of 2015 is now priced into the funds' core asset classes, which include property, infrastructure, utilities, former income trusts and royalty trusts. Overall, return expectations are limited by still high valuations. But despite the limited upside in these securities, the value of their underlying assets provides downside protection, and we are expecting returns mainly from yield in the mid-single digits.

- Should interest rates rise higher and more quickly, we can expect higher-yielding asset prices to suffer more, and in the event of disinflation and a flat rate environment, their prices should rise.
- We are now focused on investment opportunities in Asia, where there is a wealthy and aging population seeking yield investments, and in the emerging markets, where the recent rise in bond yields has had a destabilizing effect on asset values. Signature recently became one of the largest investors in Hong Kong Electric, a mature low-growth investment with high-quality assets, stable cash flow and a dividend yield of about 7.7%.

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