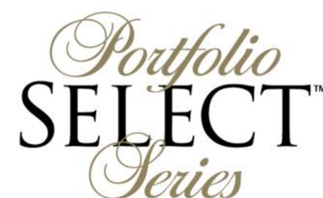
Portfolio Select Series Commentary

Second Quarter – 2019



Alfred Lam, Senior Vice-President and Chief Investment Officer

CI Multi-Asset Management

Market performance

While global economies were showing signs of slowing, stocks posted a solid performance during the second quarter of 2019. Equity markets overcame a bout of volatility in May that was triggered by concerns over the U.S./China trade war. However, the factor that overwhelmed any bad news was the increasingly dovish comments from central banks. The negative sentiment over slowing economic conditions turned positive as investors began to expect that the U.S. Federal Reserve would start cutting interest rates this year and that the European Central Bank will follow with its own version of stimulus – most likely quantitative easing (monetary policy whereby a central bank increases money supply to encourage lending and investment) as rates are already at zero. In other words, market participants decided that the trend of rising interest rates is reversing globally. Bonds rallied as investors changed from expecting rate hikes and quantitative tightening to expecting rate cuts and quantitative easing. It is difficult to believe that over US$12 trillion of debts globally now provide investors with negative interest income (yields). Investors need to extend maturity to the very long term to generate yield. For example, the Austrian 100-year bond yields just 1.1%.

The U.S. dollar weakened against the Canadian dollar as the rate differential between the two countries narrowed. In Canadian dollar terms, the Canadian stock market outperformed the U.S., a rare occurrence in recent years.

Benchmark returns in % at June 30, 2019	3 months	1 year	3 years	5 years	10 years
S&P/TSX Composite Index	2.6	3.9	8.4	4.7	7.8
S&P 500 Index (C$)	2.2	10.0	14.5	15.4	16.1
MSCI World Index (C$)	1.7	5.6	12.0	11.1	12.0
FTSE Canada Universe Bond Index	2.5	7.4	3.7	4.1	5.3

Source: Bloomberg Finance L.P., FTSE

Portfolio performance

Across the portfolios, we continued to add to our overweight position in equities in the second quarter of 2019. In the U.S. equity portion, our hedge on the U.S. dollar added to relative performance in the quarter as expectations for additional rate cuts in the U.S. put downward pressure on the U.S. dollar relative to the Canadian dollar. Strong selection from our U.S. value managers also contributed to performance, while exposure to small-cap stocks detracted. Within Canadian equity, relative performance was weak due to security selection from managers of the underlying funds. Our allocations to emerging markets and the value factor detracted from relative performance in international equities. In the income portion, our government bond position appreciated in value as U.S. 10-year Treasury yields fell below 2%. (There is an inverse relationship between yields and prices).

In 2018, our portfolios were defensively positioned, central banks were hawkish and the Fed was hiking interest rates through December. Given these developments, we believed the growth phase of this current cycle was ending and a defensive positioning was prudent. The stock market correction during the fourth quarter reflected this concern and validated our thesis. However, central banks turned dovish following the sell-off, and apparently that is all that matters to stock market participants in the near term, even if economic and corporate fundamentals continue to deteriorate. In our view, it was unusual and probably inappropriate for central

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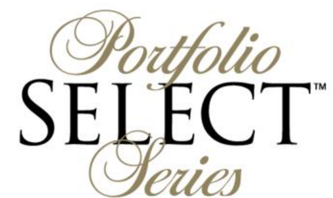


banks to change direction so dramatically and so quickly, but it is not up to us to judge. It was an unprecedented intervention and the portfolios have benefited from this tailwind.

Returns in % at June 30, 2019 (Class F)	3 months	1 year	3 years	5 years	10 years
Select Income Managed Corporate Class	2.2	5.7	2.6	3.1	n/a*
Select 80i20e Managed Portfolio Corporate Class	2.1	5.0	3.6	3.6	5.8
Select 70i30e Managed Portfolio Corporate Class	2.1	4.6	4.0	3.8	4.5
Select 60i40e Managed Portfolio Corporate Class	2.1	4.3	4.4	4.0	6.7
Select 50i50e Managed Portfolio Corporate Class	2.1	4.0	4.9	4.2	7.1
Select 40i60e Managed Portfolio Corporate Class	2.1	3.7	5.4	4.6	7.6
Select 30i70e Managed Portfolio Corporate Class	2.2	3.4	5.9	4.8	8.0
Select 20i80e Managed Portfolio Corporate Class	2.2	3.2	6.7	5.2	8.5
Select 100e Managed Portfolio Corporate Class	2.2	2.5	7.7	5.7	9.3

**Since inception return: 4.2% (Sept. 2010)*

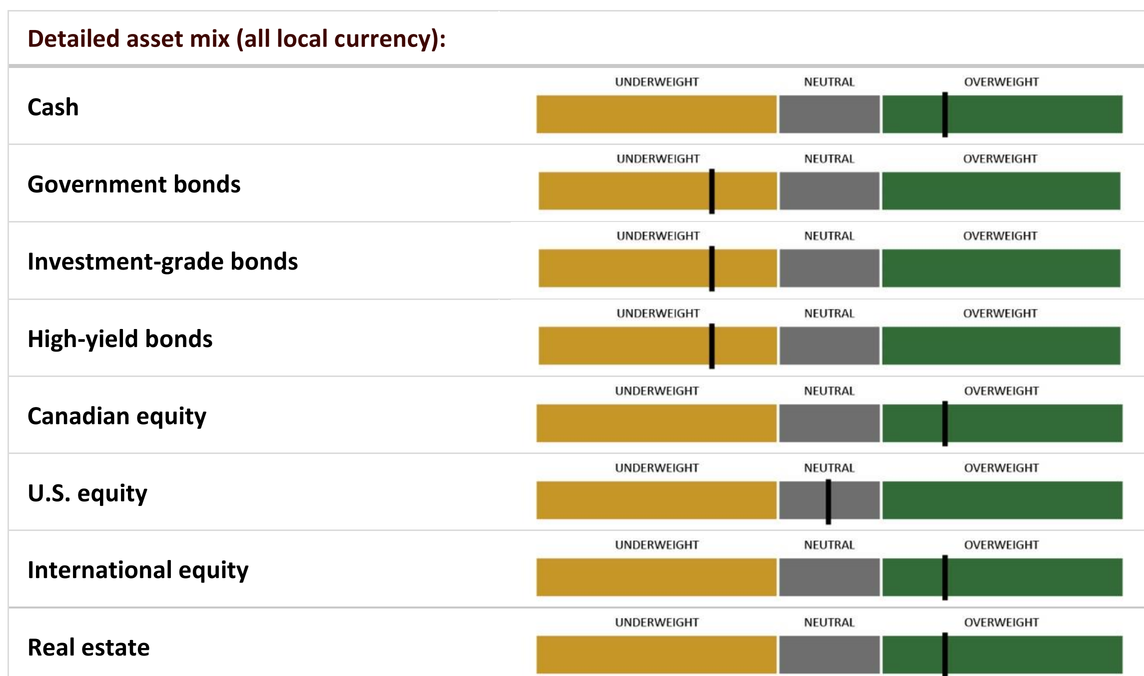
Select Income Managed Corporate Class

Since the end of the third quarter of 2018, bond positions within the portfolio performed strongly with significant capital gains as U.S. 10-year Treasury yields compressed from 3.25% to below 2.0% in June, driven by the change in the market's outlook for interest rates. We have been taking profits along the way, cutting the portfolio's government bond weight from about 42% at the beginning of the year to 29% at quarter-end. In a world where investors are not receiving much income from investing in fixed income, we have become selective and manage the portfolio with a very low fixed-income weight. Market sentiment has swung from pricing in too many interest rate increases to aggressively pricing for cuts. In our view, the downside risk of the Fed falling behind market expectations (by holding rates steady at the Federal Open Market Committee meeting on July 30-31, 2019, for example) is high relative to the benefit of any upside surprises.

The last time the portfolio had such low government bond exposure was in 2015 when we believed the easing cycle was ending. This time is very different; the easing cycle is about to begin, but the markets have already aggressively priced for that to happen. To offset the downside risk of the Fed being behind the curve, we have increased the portfolio's equity weighting to 21% (from 14% in December) and are managing this position within a range of 15% to 25%. We occasionally own gold bullion to hedge political and inflation risks. We had a large position in gold bullion that we built last year and recently exited at a profit.

We are temporarily holding a large amount of cash due to the reduction in government bond holdings, and we will deploy that cash in due course.

Outlook and positioning



Neutral weight refers to the targeted strategic asset allocation for the portfolios.
Overweight/underweight is the amount the current asset allocation differs from the neutral weighting.

The growth phase of the current economic cycle has been extended due to central banks' commitment to easing monetary policy. During the last 10 years, our global economic system was operating with over US$10 trillion of extra capital provided by central banks. This new supply of money disrupted the normal demand for financial assets, and stock and bond prices have rallied in sync with the money supply for most of this period.

In a world of zero interest rates and growing money supply, what should investors do? Let's start by saying this is unusual. If you are saying it is not sustainable today, you probably said that 10 years ago as well. We have been living through an increasing amount of money chasing scarce resources. The value of money has been diluted with every dollar printed by central banks and it is depreciating versus the value of other assets. Holding cash is simply an unattractive option as you are almost guaranteed to have less purchasing power in the future, even if you earn some interest. It is possible for central banks to print a trillion dollars overnight, but it is impossible to construct a building or develop a company overnight.

We have progressively turned bullish on equities as central banks have signalled their intent to begin easing monetary policy. We expect the value of money to be diluted again, causing asset prices to increase. The opportunity cost of holding cash versus equities is very high, but is less of an issue versus bonds, which have become very expensive. We have repositioned our portfolios by trimming government bonds and adding stocks. Even though our stock weight is higher than the benchmarks, the stocks we own are selected by the portfolio managers of our underlying funds and that gives us assurance there is a good margin of safety. We expect this to be maintained as long as central banks remain dovish.

Portfolio SELECT™ Series

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