CI Multi-Asset™ Management

CI Multi-Asset Management Market Update

Summary of a Conference Call on March 12, 2020

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Overview:

- 2020 was set to become a pretty good year for earnings and economic growth, due in part to the lower interest rates, however markets have been negatively impacted in recent weeks by both the spread of the coronavirus and an oil price shock.
- The coronavirus arose in January 2020 in China, and North American markets initially responded much like they had during the SARS outbreak of 2003, which was quickly contained. Unfortunately, this is not the case this time around. The virus has spread across the globe and people are very concerned. It is having a large impact on consumption as people are staying home, not travelling or going out as much.
- There has been a significant disruption in China with the supply chain operating at about 20% capacity for a while. Fortunately, China is seeing fewer cases of the virus each day and things are already starting to improve.
- Given the uncertainty it is hard to know what the ultimate impact will be on earnings.

Oil price war:

- The OPEC nations were expected to slow the production of oil, but Saudi Arabia, in a conflict with Russia, started increasing production, which drove the price of oil down and created a price war. This triggered a dramatic price decline on Monday March 9, strongly impacting Canada's energy sector.
- Bond markets also dropped on Monday March 9 because people were expecting deflation.
- Consumers are using less oil than in the past so the overall impact of the correction was not as big as might have been previously. On the flip side, low oil prices are good news for consumers at the pumps where we are seeing gas prices below the $1.00 mark for the first time in a while. So while the drop in oil to US$30 a barrel is bad news for oil producers, there is some upside.
- We saw a similar decline in 2016 when oil dropped to $30 a barrel, so this is not unheard of. It is hard to predict how long this current price war will go on. Russia needs oil prices to be at least $40 a barrel for them to see a profit, U.S. shale producers need about $50, but Saudi Arabia can tolerate lower prices.

Coronavirus impact:

- From February 19 to March 16, the markets dropped about 10%, and foreign currencies all rallied against the Canadian dollar. Why are foreign currencies doing better than U.S. and Canadian dollars? Before coronavirus Canada and the U.S. were high-yielding currencies with central bank rates at 1.50% to 1.75% higher than the rest of the world at 0% or 0.25%. Now, the markets are expecting Canada and the U.S. to go to 0%.
- While the central banks and governments are being criticized for not doing enough and not moving fast enough, they have reacted very quickly compared to other crises. With tools like quantitative easing already in place, central banks can buy government bonds, corporate bonds, income trust and stocks without needing to wait for a new financial tool to be engineered.
- Central banks and governments are providing economic stimulus packages that are targeting the real economy so more people will benefit from the stimulus. There are plans for more fiscal spending and tax cuts so it's not just those with financial assets who will benefit.
- Over the past few weeks the best performing sectors are staples, health care and utilities. The worst performing sectors are energy and financial sectors because of declining interest rates. It's harder for banks to have good margins in a declining interest rate environment and more people are worried about a recession.
- On March 3, the U.S. Federal Reserve made an emergency cut of 50 basis points (bps), taking interest rates to range of 1% to 1.25%. The Bank of Canada cuts 50 bps to 1.25%. The European Central Bank (ECB) did not cut interest rates because they are already negative, but they are providing funding to small businesses to keep their cash flows fluid. The ECB is also allowing banks to relax their reserve ratio to allow for more lending, while individual countries are being allowed to run larger budget deficits and do more spending. China is also being very aggressive to ensure the credit market is fluid, pumping money into the system, cutting reserve and interest rates. If this isn't enough there will likely be more coming as it is in everyone's interest to avoid a recession.
- 10-year sovereign bond yields have fallen. Canada is at .5%, U.S. is at .5%, UK .1%, Germany -.9%, France -.4%, Japan -.2% and Italy is at 1.4% because people are concerned about the credit quality in Italy.

CI Multi-Asset Management's positioning:

- Being significantly overweight risk assets during a really strong year in the stock market benefitted CI's managed solutions in 2019, and we continue to have an underweight allocation to fixed income as bond yields backed up towards the end of the year. We

entered 2020 more constructive on risk assets, because pre-virus it looked like GDP growth would be revised upward given the effects of looser monetary policy.

- Though 2019 was a good year in the stock market, a lot of that was multiple-driven. We had a tough year in terms of fundamentals. Earnings didn't grow at all; in fact, we had a bit of an earnings recession.
- Government bonds are offering a lot of return-free risk. Negative real rates of return across the entire yield complex in terms of sovereign bonds doesn't square with a solid market environment we saw pre-virus. There will be a significant short-term hit but we do not see a long-term one.
- Broadly speaking within Portfolio Series, Portfolio Select Series and CI Mosaic ETF Portfolios, value strategies have continued to underperform in this low interest rate environment, while momentum continues to be the favourite factor, and the broader market outperformed value.
- Some of our growth managers have also outperformed from certain sources of alpha, including stock selection, sector selection and some foreign holdings. This is what we need to see; active management plays a great role. We expect when fundamentals become a focus again that it will continue to be a tailwind for us.
- Our global bond positioning outperformed. Global rates fell quickly and we had some foreign exchange gains because global bonds are not hedged.
- Normally we might be three-quarters hedged on our U.S. dollars based on our dynamic model, but we are currently only about 50% hedged in our portfolios.
- It may be gold's time to shine in this environment. Gold doesn't pay a coupon and has been seen as a wasted asset in the past, but as yield curves converge to 0%, the return potential could be large if inflation rises. We will be more incremental and gradual in terms of increasing the equity weighting in our portfolios. We want to outperform the markets and add value from this market correction.
- Credit market stress is being seen at these rates and spreads are widening across a lot of the corporate credit market. Its good to see fiscal stimulus coming out of the woodwork as quantitative easing is reaching the limit of its effectiveness; it had a limited direct impact in the real economy but is helpful as it reduces risk premiums and enhances liquidity.
- Our tactical position here is we have been lighter on credit exposure and more broadly are underweight high yield and emerging markets.
- We're underweight bonds overall, including governments, seeing no long-term value there at all. We are seeking alternative defensive strategies including the yen, U.S. dollar and gold.

- Broadly speaking we're overweight defensive sectors; there will be an opportunity for cyclicals to emerge but it is too early. We're adding to equity in this drawdown in longer-term portfolios but being less aggressive in more conservative portfolios for those who need liquidity.
- In terms of a performance update, the conservative mandates have been best, though we are trailing benchmarks due to underweight duration in the portfolios. Growth portfolios are down but generally in line with current benchmarks.

CI Mosaic ETF Portfolios

- Within Mosaic we're closer to neutral across the portfolios but still a little overweight equity, we have been dollar cost averaging on stocks as they've fallen but not as aggressively as we'd anticipated. Within the equity portfolio we do have a defensive posture, we're overweight factors like momentum and low volatility and sectors like real estate, utilities and staples. We've added liquid alternatives with the launch of our new CI Munro Alternative Global Growth Fund. We're underweight credit exposure overall and underweight government duration.

CI Select Income Managed Corporate Class

- CI Select Income Managed Corporate Class is a very defensive portfolio for conservative investors which is performing well vs. its peers. We're effectively flat in terms of performance. We were holding about 20% cash, which was beneficial because cash is now seen as king as we aim to preserve capital.
- CI Select Income Managed also owned some asset classes like gold bullion and yen, which is unusual for a Canadian income fund. We think the yen is very effective to offset some risk in the portfolio. We expect to be late adding equity to this portfolio as clients are conservative and cannot endure equity market volatility as they may need the liquidity in the short term.
- When we stress test the current portfolio, we would expect the portfolio to lose 2.5% on an annual basis in a worst-case scenario, which is very conservative. We will adjust on an ongoing basis depending on prevailing market conditions. If government bond yields back up we will probably buy government bonds, if credit spreads widen we may increase our allocation to credit, and if stocks drop a little bit more we will be buying stocks There is no fixed path and that is the beauty of the product, allowing us to shop for the best value in the current market.

Source: Bloomberg Finance L.P. and CSI 300 Index

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