Market commentary

Brexit webcast summary
June 27, 2016

Below is a summary of a webcast held on Monday, June 27, 2016, in which a number of CI portfolio managers discussed the implications of the vote by U.K. citizens to exit the European Union.

Signature Global Asset Management
Eric Bushell, Chief Investment Officer

- The vote could unleash a chain reaction of Euro-skepticism. A fuse has been lit in Brussels – the EU has a short window of time (maybe a year or two) to formulate and articulate a new vision of Europe.
- The EU will also need to decide the U.K.'s "punishment" for leaving. Resolving these issues will be more difficult due to potential leadership changes in France and Germany and the lack of leadership currently in the U.K.
- A major risk is the potential acceleration of a breakup of the EU.

Markets

- The markets are functioning, there is liquidity in credit and equities. Bonds have had a massive rally.
- The U.K. is adjusting, with the pound falling sharply, and the Bank of England is prepared to intervene. Further rate hikes by the U.S. Federal Reserve are off the table and it's also likely the European Central Bank will extend its quantitative easing.
- Continuing low rates and negative interest rate policies in Europe threaten bank profitability. However, the capital position of the U.K. banking system looks sound despite reduced profitability. The Italian banking system represents a risk. It is undercapitalized, suffering from high levels of non-performing assets and doesn't have an obvious source of new equity capital.
- We expect the European economy to have 0.5–1% growth going into 2017, with a weaker euro, which may hurt China.

Portfolio positioning

- There is no real change from recent weeks – the funds have been defensive with a focus on developed markets and consumer services and a reduced emphasis on cyclical sectors. The balanced funds have approximately 8% cash and about 7% in gold, which went up in response to the vote. We expect to reduce the gold weight in favour of equities when we decide the time is right.
- Signature Global Income & Growth Fund had a higher level of cash at 17%, and gold at 10%.

Market commentary

Cambridge Global Asset Management
Brandon Snow, Co-Chief Investment Officer, and Greg Dean, Portfolio Manager

- Valuations have not been that attractive, so we have been maintaining high cash levels. However, the market dislocation following the referendum created some buying opportunities for companies that had been on our list to acquire once their valuations became reasonable, and we put some of that cash to work.
- Despite the shock, at the end of day, people don't know what the real impact will be. So we continue to look for good value in businesses with solid long-term growth prospects, which so far have included stocks such as those of low-cost retailers and technology companies. We are methodically increasing levels of investment in well-priced sectors and companies where we think it makes sense from a long-term investment perspective.
- What is playing out is similar to what occurred in Canada two years ago (when oil plunged and with it the dollar). Opportunities for robust, stable investments are showing up around the world, not just in the U.K. Good business models that are robust for the most part will do well over time, regardless of events such as Brexit.
- We have maintained high cash positions in our funds in a market where investors have been eager to overpay for stocks that offer high dividend payouts – but we don't see the value in doing so. Our cash exposure is for the most part in lieu of having positions in utilities and REITs. Our asset allocation has remained much the same for the past three months. The only change in recent days is that we have increased our exposure to the U.K. pound and U.S. dollar.
- Brexit has not significantly changed our view on China and other Asian markets, where we believe that flight of capital from these markets will continue to have a negative effect on valuations.
- Regardless of Brexit, there continues to be a lack of liquidity in capital markets. Other than the post-Brexit strengthening of the U.S. dollar, market fundamentals have not significantly changed. We have not seen credit markets stop functioning or other drastic reactions. There is a need to remain disciplined in this environment.

Harbour Advisors
Roger Mortimer, Senior Portfolio Manager

- The British vote to leave the European Union is the first step into a much more complicated situation. Now is the time for continued caution.
- The five main areas we are monitoring are:
    - Currencies – The Brexit decision has been negative for sterling and other currencies and positive for the U.S. dollar. Developed market currencies have never been as volatile as in the days after the vote. Currency volatility tends to cause corporate paralysis as companies face difficulties in making decisions.

  - Interest rates – We are in a sustained low interest rate environment. The U.S. Federal Reserve likely will not raise interest rates for the rest of year.
  - Growth – The decision to leave is a nationalistic action and is a step away from free trade. It will make companies hesitant to invest in the U.K.
  - Politics – Brexit and political figures like U.S. presidential candidate Donald Trump would not be popular unless there was an undercurrent of significant discontent.
  - Financial services sector – Banks have been impacted by a flatter yield curve, market volatility and lower equity valuations.
- Performance of the Harbour funds was first quartile on June 24, 2016. We were positioned to protect against the downside.
- We are conservatively positioned with underweight positions in equities, financial services, the United Kingdom and Europe, and hedges on the sterling and euro.

Ryan Fitzgerald, Senior Portfolio Manager

- Since being appointed lead manager of the Harbour equity funds in April, Ryan has made a number of changes that have reduced the volatility and cyclicality of the funds.
- We are re-evaluating all of the holdings to see if they still make the cut. Some names that have been sold so far are Discover, Richemont, Tiffany & Co., Potash, Citigroup, and UBS.
- Cash levels, U.S. dollar hedge and exposure to gold have been increased in the portfolios.
- We do not have any exposure to European banks. Global banks will face difficulties. We have exposure to one global bank, Wells Fargo, which is not overly exposed to the current market pressures.
- We have one U.K. holding, global beverage company Diageo, and its share price went up.

CI Investment Consulting
Yoonjai Shin, Associate Portfolio Manager

- Central bankers are ready to step in, if needed, to stabilize markets after the vote.
- Brexit is an event that will take years to play out. We anticipate that the U.K. will slip into recession.
- Will globalization reverse? We doubt it, but some people have been left out and some accommodations will likely be needed for them.
- One question is whether Britain and the EU will end up with some kind of deal that is favourable to trade.
- CI's managed solutions continue to focus on a disciplined portfolio construction process, rather than market predictions, to achieve the long-term goals of our investors. We pay attention to valuations, fundamentals and correlations.

- Our portfolios draw on a broad range of asset classes to provide predictable outcomes and reduce volatility.
- In the wake of Brexit, correlations between assets classes, including stocks and bonds, for example, have held up as expected. This has allowed our portfolios to benefit from diversification. While some assets (stocks) have declined, others (bonds) have increased in value.
- We remain cautious – especially for our more conservative portfolios.
- We protect against unanticipated events by playing defence with asset classes that have asymmetric payoffs. For example, U.S. Treasury bonds are an excellent example because they offer upside when markets are unsettled and provide our portfolios with support through an attractive relative yield.
- On June 24, CI Income Fund and Select Income Managed Corporate Class each gained 26 basis points. Year-to-date, those mandates have gains of about 2% (Class A). Currently, the cash weightings in these mandates are about 12% to 13%, compared to about 15% to 20% during normal periods.
- We actively manage currency exposure. In early 2016, the U.S. dollar was overvalued, so we reduced our exposure to that currency. More recently, we have added to our U.S. dollar exposure because we believe it offers good value.

Black Creek Investment Management
Richard Jenkins, Managing Director and Portfolio Manager

- We have experience investing in market crises dating back to 1987. Crisis or not, we invest in companies that are global leaders in what they do, companies that are taking market share, and those that we think will win on a 10-year basis. Going into this downturn our global equity and balanced funds were about one-third exposed to Europe, as measured by revenues and profits, of which about 7% was in the U.K.
- The post Brexit sell-off seems overdone. London remains the world's financial headquarters, and investors there are wondering about their future. Investors hate uncertainty, and they likely have over-discounted the impact of the crisis.
- It is important to consider how the current crisis will affect individual industries and companies. Will fewer people take cruises, will they make less use of information technology, will they go to the grocery store less often, will they use less gravel to build roads, less natural gas to heat their homes. These questions are related to companies we own in our portfolios, some of which have recently suffered significant drops. The answer to most of those questions is no, and so we are increasing our weightings.
- As well, the crisis has created some attractive opportunities for companies that have been on our watch list. In Japan, for example, some stocks have fallen dramatically even though they have no exposure to the U.K.

- Broader issues related to changes in pensions, health care, immigration, and generational transfers of wealth have been playing out in this vote. We saw the same thing in our federal election last year, and also in Spain, Italy and the United States.
- We take a long-term fundamental approach on currencies based upon purchasing power parity. Until this week, the British pound was trading roughly in line with its purchasing power relative to the Canadian dollar, and that is our reference point. So if a currency becomes cheap, we are interested, and if something gets expensive, we will act and hedge our position, as we did with our U.S.-dollar exposure at the beginning of this year.