Market Commentary

First Quarter 2016

CI Investment Consulting

Portfolio Series and Portfolio Select Series

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Market performance

A reduced outlook for global economic growth kept investors guessing and central banks panicking in the first quarter. Equity markets, as measured by the MSCI World Index, lost 12.5% through February 11 and finished the quarter with a loss of 2.5% (in local currency terms). The tone changed to positive when the European Central Bank and the Bank of Japan launched new unconventional policies to address the economic slowdown. In addition to buying government bonds, the ECB will also be buying corporate bonds to drive yields lower. The Bank of Japan cut deposit rates to negative to respond to slower growth and low inflation. The U.S. Federal Reserve, which hiked rates in December of 2015, put the plan for further rate hikes on hold, at least until the second half of the year.

Oil prices rebounded and the Canadian dollar rallied strongly against other major currencies, creating headwinds for Canadians investing in foreign markets. In Canadian dollar terms, the MSCI World Index lost 6.3% for the quarter.

Returns in % at March 31, 2016	3 mo	1 yr	3 yr	5 yr	10 yr
S&P/TSX Composite Index	4.5	-6.6	5.0	2.1	4.1
S&P 500 Index (C$)	-4.9	4.4	21.4	18.3	8.2
MSCI World Index (C$)	-6.3	-0.5	16.6	13.6	6.0
FTSE/TMX Canada Universe Bond Index	1.4	0.8	3.9	5.2	5.2

Source: Bloomberg, FTSE/TMX

It has been challenging to generate attractive short-term results both from the equity and the bond markets. For a while now – six years to be precise – we have been “stuck” with mediocre global economic growth, frequent and dramatic central bank interventions, currency wars between countries, and a lack of outperformance from investing in high-quality companies. We have addressed the first few issues by avoiding the noise and remaining focused on long-term fundamentals and not chasing short-lived themes in the markets. We are sensitive to valuations and have used volatility to rebalance our asset mix and currency exposure – effectively practising "buy low and sell high." Those decisions have added value and should continue to do so.

What we have not been able to do is to purposely own low-quality companies in our portfolios. In particular, this means companies that do not have a business model that will survive a normal economic cycle, which includes interest rates that are higher than today's. Given the extended period of low interest rates, such companies are not only surviving but growing. Every now and then, one of them blows up, as their ability to borrow and their cost of borrowing changed overnight.

A well-known example in Canada is Valeant Pharmaceuticals. The company had been growing by acquisitions funded by borrowing. In an environment where the return on investment is above the borrowing cost, this strategy is accretive to shareholder value. The share price rose as high as $346 in 2015 but recently traded at a fraction of that, ending at $35.05 as of March 31, 2016. Its borrowing cost last year on a 10-year loan was as low as 5.45% but jumped to 10.38% in 2016. It only takes a marginal change in company fundamentals to prompt lenders to re-price loans. There are many other examples in the commodity sector, but there are also many other firms that survive and are creating "value." Nevertheless, we won't be changing our focus on quality.

Select Income Managed Corporate Class

We discussed last quarter our plans to make some changes to the portfolio with a goal of earning premium interest income and achieving lower levels of volatility. We began to implement the changes in January and were finished by end of the quarter. There was an immediate impact in reducing the fund's volatility during what was a volatile quarter for capital markets.

With regards to interest income, this year we aim to collect 3% to 4% income from a diversified basket of global government bonds, corporate bonds, real estate investment trusts, and dividends from equity. This compares to 0.7% offered by a five-year Government of Canada bond. At that rate, inflation protection is not met and interest rate risk is high. Our portfolio earns a premium and we reduce and balance the inflation and interest rate risks with the appropriate amount of equity risk. Equity risk is low to begin with due to the low weighting (as stock markets rallied in the middle of the quarter, we lightened the portfolio's equity exposure to 14%), but it is further reduced as the bond holdings tend to perform well when equities do poorly.

We are delighted to have an opportunity to add to our U.S. dollar holdings in the portfolio. The U.S. dollar is a unique asset class that generally has a negative correlation to risk and has earned safe haven status. We were hesitant to own the U.S. dollar when it was bid up to $1.46 in January and we have used recent weakness to bring our exposure to 25%. The downside risk at the current level of $1.30 seems low, with the payoff being the potential for a positive return and protection against a market downturn.

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Returns in % at March 31, 2016	3 mo	1 yr	3 yr	5 yr	10 yr	Life
Portfolio Series Income Fund	-0.8	-1.3	5.4	5.7	4.8	5.2 (Dec. 97)
Portfolio Series Conservative Fund	-2.2	-3.8	5.6	5.1	3.9	5.0 (Dec. 97)
Portfolio Series Conservative Balanced Fund	-2.5	-4.3	6.3	5.6	3.9	4.8 (Dec. 01)
Portfolio Series Balanced Fund	-3.0	-5.0	6.6	5.7	3.8	6.8 (Nov. 88)
Portfolio Series Balanced Growth Fund	-3.2	-5.2	7.2	5.9	3.7	4.5 (Dec. 01)
Portfolio Series Growth Fund	-3.5	-5.5	7.9	6.3	3.5	4.2 (Dec. 01)
Portfolio Series Maximum Growth Fund	-4.3	-6.3	9.0	6.6	3.2	3.8 (Dec. 01)
Select Income Managed Corporate Class	-0.1	-2.0	3.1	4.0	n/a	3.7 (Sept. 10)
Select 80i20e Managed Portfolio	-0.6	-2.7	4.2	4.6	n/a	3.7 (Nov. 06)
Select 70i30e Managed Portfolio	-1.0	-3.3	4.6	4.8	n/a	3.6 (Nov. 06)
Select 60i40e Managed Portfolio	-1.3	-3.8	5.1	5.1	n/a	3.5 (Nov. 06)
Select 50i50e Managed Portfolio	-1.6	-4.2	5.7	5.4	n/a	3.5 (Nov. 06)
Select 40i60e Managed Portfolio	-1.7	-4.4	6.4	5.8	n/a	3.5 (Nov. 06)
Select 30i70e Managed Portfolio	-2.0	-4.7	6.9	6.0	n/a	3.4 (Nov. 06)
Select 20i80e Managed Portfolio	-2.0	-4.9	7.6	6.4	n/a	3.4 (Nov. 06)
Select 100e Managed Portfolio	-2.5	-5.5	8.8	6.9	n/a	3.1 (Nov. 06)

All fund returns are for Class A units/shares

Outlook and positioning

We have always been sensitive to valuations and fundamentals, and it is also important to pay attention to central bank policies as they affect short-term valuations and fundamentals. Following seven years of unconventional policy by central banks, growth is positive, but weak and uneven from country to country. The job for active investment managers has only gotten more difficult. We have seen this challenge as a long-term trend and have positioned our portfolios accordingly. Even though bond yields have been lower than normal, we have been committed to the asset class and have earned attractive returns. At various times, bonds have also been helpful in offsetting equity volatility. Our equity exposure is determined by the risk profile of the portfolio, the valuations of the markets and the value relative to other investments such as high-yield corporate bonds and government bonds.

We continue to utilize our expertise in multiple asset classes to optimize our portfolios for some growth and stability. As market volatility continues to increase, we have been deploying strategies to offset some of the volatility. Recently, besides adding the U.S. dollar exposure, we have also added long-term U.S. Treasury bonds and, at the margin, we have reduced equity exposure. We prefer incremental changes to dramatic moves, as the cost of being wrong is too high in an environment where returns are expected to be lower than normal.