Market Commentary

Third Quarter 2016

Portfolio Series and Portfolio Select Series

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Market performance

The world is full of surprises. Many investors believed that the stock market correction in January and February was the beginning of a bear market; they were wrong. Stocks were higher at the end of September than they were at the beginning of the correction. Britons voted to exit the European Union in June (first surprise) and stocks globally dropped for two days before rallying. Prices moved above pre-Brexit levels in the third quarter (second surprise). The U.S. Federal Reserve was expected to hike rates four times in 2016 but has not yet moved once and there are only two policy meetings left for the year. In the bond market, government bonds that have low yields, or even negative yields, have outperformed those with higher yields.

The dominating force in all of these stories has been very accommodating central bank policies. The Bank of Japan, the Bank of England and the European Central Bank are spending US$2 trillion combined a year in various quantitative easing programs. These programs have one mission: rejuvenate growth and inflation. Are they effective? Growth has been mediocre and inflation is hovering between 0 to 1% for most economies. You could argue that things would be worse without the stimulus. However, the side-effect has been a significant growth in asset prices.

Returns in % at Sept. 30, 2016	**3 mo**	**1 yr**	**3 yr**	**5 yr**	**10 yr**
S&P/TSX Composite Index	5.5	14.2	8.0	8.0	5.3
S&P 500 Index (C$)	5.4	13.5	20.5	21.7	9.0
MSCI World Index (C$)	6.6	10.1	15.4	17.4	6.8
FTSE/TMX Canada Universe Bond Index	1.2	6.3	6.0	4.4	5.2

Source: Bloomberg, FTSE/TMX

Portfolio Series and Portfolio Select Series

With an “every asset class wins” backdrop to the markets, positive returns were easy to come by this quarter. However, when considering our responsibility to evaluate downside risk in addition to the upside potential, the job has not been easy. Last quarter, we wrote this for our outlook and positioning:

“We aim to bring more stability to an uncertain and volatile world, and not the vice-versa. We are very sensitive to the risk we take and how much we get paid for doing so. As a result, compared to a year ago, we are holding less equity that is economic-sensitive and owning more income-generating assets that include government and corporate bonds. This may lead to underperformance relative to the benchmark and our peer group from time to time.”

This positioning has not changed as valuations have been rising not declining. In an environment where taking large market risk generally leads to strong performance, our defensive positioning detracted some value. This means the positive return that we earned could have been better if we kept the same market exposure as we used to when valuations were lower.

However, some of our holdings turned out to be real winners. To name a few, Whistler Blackcomb and Spectra Energy were acquired at significant premiums. We also own Nintendo, which saw its share price rally on the global popularity of “Pokemon Go.”

The income-centric portfolios have performed strongly. A positioning that is overweight long-dated bonds and corporate bonds, which we believed to be undervalued, added value.

Returns in % at Sept. 30, 2016	**3 mo**	**1 yr**	**3 yr**	**5 yr**	**10 yr**	**Life**
Portfolio Series Income Fund	2.8	6.2	6.7	6.8	5.3	5.4 (Dec. 97)
Portfolio Series Conservative Fund	3.6	5.7	6.7	7.3	4.5	5.2 (Dec. 97)
Portfolio Series Conservative Balanced Fund	4.1	6.1	7.2	8.3	4.5	5.0 (Dec. 01)
Portfolio Series Balanced Fund	4.5	6.3	7.5	8.9	4.4	6.9 (Nov. 88)
Portfolio Series Balanced Growth Fund	5.2	6.9	7.7	9.6	4.5	4.8 (Dec. 01)
Portfolio Series Growth Fund	5.6	7.1	8.1	10.4	4.4	4.5 (Dec. 01)
Portfolio Series Maximum Growth Fund	6.4	7.7	8.9	11.7	4.3	4.2 (Dec. 01)
Select Income Managed Corporate Class	2.2	5.3	4.6	4.9	n/a	4.2 (Sept. 10)
Select 80i20e Managed Portfolio	2.8	5.6	5.2	6.2	n/a	4.0 (Nov. 06)
Select 70i30e Managed Portfolio	3.2	5.6	5.4	6.8	n/a	3.9 (Nov. 06)

Select 60i40e Managed Portfolio	3.5	5.6	5.7	7.4	n/a	3.9 (Nov. 06)
Select 50i50e Managed Portfolio	3.8	5.9	6.0	8.0	n/a	3.8 (Nov. 06)
Select 40i60e Managed Portfolio	4.2	6.2	6.4	8.8	n/a	3.8 (Nov. 06)
Select 30i70e Managed Portfolio	4.5	6.3	6.7	9.4	n/a	3.8 (Nov. 06)
Select 20i80e Managed Portfolio	4.9	6.9	7.3	10.2	n/a	3.8 (Nov. 06)
Select 100e Managed Portfolio	5.7	7.5	8.0	11.5	n/a	3.6 (Nov. 06)

All fund returns are for Class A units/shares

Select Income Managed Corporate Class

Select Income is a unique mandate designed to generate a steady result in most economic environments, including the current low interest rate world. Investors typically hold it for the short term, approximately two to three years. The challenge is that there is no one single asset class that will secure a positive return for that holding period. For example, a 1% rise in bond yields will wipe out approximately five years of interest income if you invest in the core bond markets as represented in the FTSE TMX Universe Bond Index. A bear market in stocks typically last longer than two years and requires additional years to recover.

Unless you have perfect insights about the future, the only option is to diversify and take advantage of negative correlations between asset classes. We have worked diligently to optimize the portfolio and it now includes over 10 asset classes, each of which performs differently than the others. This strategy has weathered the global financial turmoil, the Greek referendum, the U.S. debt ceiling debate, the taper tantrum, and Brexit – all with impressive downside protection. As of September 30, 2016, every investor who has held this portfolio for two years or longer has earned a positive return regardless of their timing of investing.

Performance of Select Income Managed Corporate Class on a rolling basis:

Periods	1yr	2yr	3yr
Earned a positive return	90%	100%	100%
2% or more (annualized)	82%	96%	100%
3% or more (annualized)	73%	88%	94%
4% or more (annualized)	63%	73%	75%
Best	7.5%	6.1%	6.0%
Worst	-2.6%	1.9%	2.7%
Average	4.2%	4.6%	4.7%

Market Commentary

Outlook and positioning

We will not complain if the markets continue to surprise us with large positive returns. We continue to make adjustments that include country allocations and manager selection. We are adding Canadian exposure gradually as evidence suggests that fundamentals and valuations are bottoming. We have increased the allocation to Black Creek Investment Management, a group of experienced portfolio managers who have added substantial value over time through high-conviction globally oriented portfolios. We introduced a global low-volatility equity strategy to our portfolio programs through investments in factor-based exchange-traded funds, which complement the existing value and growth styles of CI's active investment teams.

The correlation between bonds and stocks appear to be edging higher in the near term in anticipation of tighter U.S. monetary policy, which may reduce the effectiveness of diversification. We continue to hold some cash and have increased exposure to the U.S. dollar, as currency is another element of diversification. Given the significance of energy to the Canadian economy, our dollar tends to have high correlation to global growth and stock prices. We expect that holding the U.S. dollar can be a very effective offset to risk as long as it is priced at reasonable or attractive valuations. We expect to remove some of these defensive measures when we see improving fundamentals or declining stock valuations.