Portfolio Select Series Commentary

First Quarter – 2019

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Market performance

The start of 2019 saw global economies continue to slow, and Brexit and U.S.-China trade remain uncertain, but what really mattered to investors was the U.S. Federal Reserve's dovish tone in January. Within a month, expectations went from rate hike to rate cut, the most dramatic change in the Fed's history, and all asset classes rallied during the first quarter as a result. While corporate earnings are expected to decline, the price-earnings ratio, which is a measure of investors' willingness to pay for future earnings, has increased to support this rally. Looking at bonds, even though central bank rates have not yet changed, the markets are pricing for central banks to cut soon. Investors are buying bonds to lock in current rates, assuming future cash rates will be lower.

Returns in % at March 31, 2019	3 months	1 year	3 years	5 years	10 years
S&P/TSX Composite Index	13.3	8.1	9.3	5.4	9.5
S&P 500 Index (C$)	11.5	13.4	14.7	15.2	16.6
MSCI World Index (C$)	10.0	7.9	11.9	10.9	13.1
FTSE Canada Universe Bond Index	3.9	5.3	2.7	3.8	4.4

Source: Bloomberg, FTSE

Portfolio performance

In 2018, the pace of global economic growth began to slow as consumption and production appeared to reach capacity; central banks in North America were raising rates and seemed committed to this course of action. Investor expectations were very high as they were looking backward to predict forward. We did see a correction in the fourth quarter and, being rational investors, we welcomed the change, thinking that markets were "normalizing."

While the economic picture has not changed from late 2018 to 2019, central banks have turned 180 degrees from being somewhat "hawkish" to very "dovish." In a late cycle, investors would normally hold more cash. However, that prudent approach turned out to be the worst strategy as all other asset classes generated very positive returns on the back of very inconsistent and unusual central bank policies on both interest rates and money supply. In December, for example, the Fed indicated that rates at current levels were a few hikes from neutral, then changed course in January, hinting that rates were not rising. It was also unusual because the extra money supply that was pumped into the system after the financial crisis for emergency purposes is now considered permanent, as the Fed claimed in January that quantitative tightening efforts were closer to the end. That's almost three trillion dollars! The Fed's January statement has effectively put a floor on asset prices by implying that if things get more challenging, it will bail out investors with lower interest rates and by adding money supply – a "Fed put" so to speak. Everything from stocks to bonds rallied strongly on those words alone. It was not about what you bought, it was when that mattered.

Recognizing the Fed action was a powerful source to quickly influence investor confidence, we repositioned the portfolios for more market upside. We cut exposure to investment funds that had held a larger amount of cash and increased the allocation to equity funds. In addition, we removed the market hedge strategy that invested in put options, so as not to be redundant with the Fed put. Note, a put option is a contract giving the owner the right, but not the obligation, to sell a specified amount of a security (in this case, the S&P 500 Index) at a specified price within a specified time frame.

Our portfolio returns for the last three months were strong. We expect markets to continue to make short-term gains, albeit at a lower rate, provided the Fed doesn't pivot again. We remain slightly overweight equity, but are holding less bonds as they have gotten very pricey. About one-fifth of the world's fixed income is now expected to lose money if the investor holds the investment to maturity. This is the type of "abnormal" scenario that was created by central banks. We'd rather hold cash and be paid a couple of percentage points than wait for the next entry to bring our bond weight back to target.

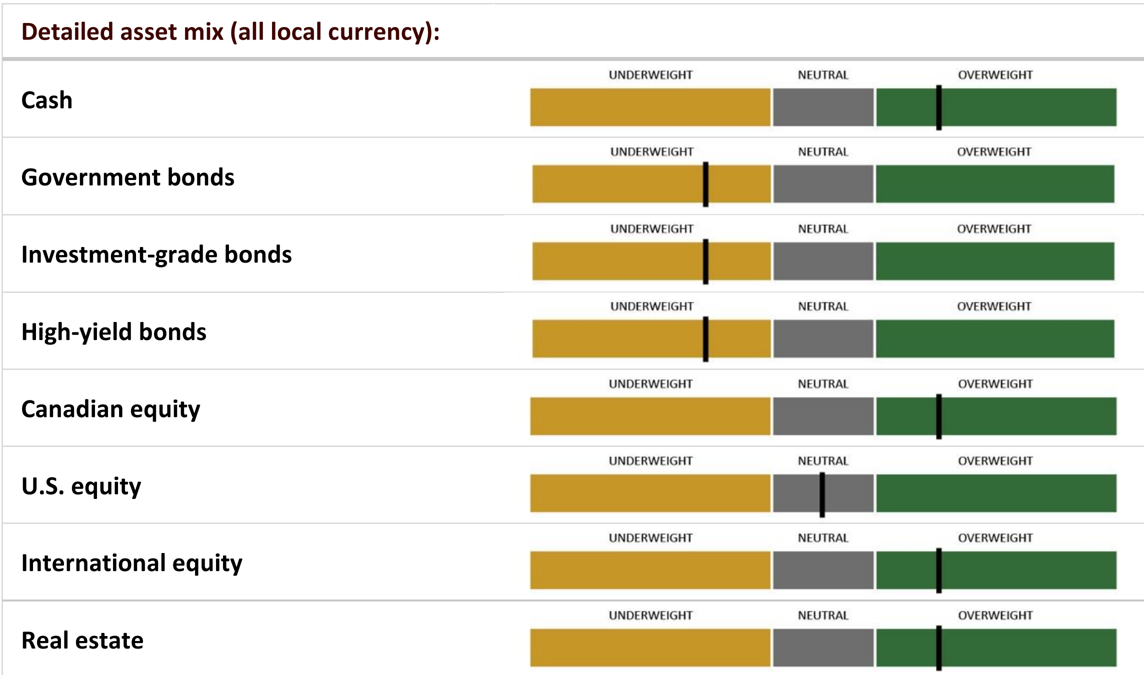
Returns in % at March 31, 2019 (Class F)	3 months	1 year	3 years	5 years	10 years
Select Income Managed Corporate Class	3.8	3.5	2.8	2.9	n/a*
Select 80i20e Managed Portfolio Corporate Class	4.8	3.1	3.6	3.5	6.1
Select 70i30e Managed Portfolio Corporate Class	5.2	3.0	4.0	3.6	4.3
Select 60i40e Managed Portfolio Corporate Class	5.6	2.8	4.4	3.9	7.2
Select 50i50e Managed Portfolio Corporate Class	6.1	2.7	4.7	4.1	7.7
Select 40i60e Managed Portfolio Corporate Class	6.6	2.7	5.2	4.5	8.3
Select 30i70e Managed Portfolio Corporate Class	7.3	2.6	5.6	4.7	8.8
Select 20i80e Managed Portfolio Corporate Class	8.0	2.5	6.3	5.2	9.5
Select 100e Managed Portfolio Corporate Class	8.9	2.3	7.2	5.8	10.5

**Since inception return: 3.9% (Sept. 2010)*

Select Income Managed Corporate Class

After a rally in sovereign bond prices, which took the yield on both U.S. and Canada 10-year bonds below that of cash, we reduced our sovereign bond weighting and duration. The portfolio is temporarily carrying more cash. We added equity, believing the current backdrop of a dovish stance from central banks globally and some economic expansion would support growth in equity valuations. Within equity, we favour income-producing sectors, including REITs and infrastructure. We also added emerging markets and Japan, each at 1.5% weighting, which are both trading at significant discounts in our opinion. We have cut gold bullion exposure by half and will continue to trim it on strength. The fund has earned almost 4% year-to-date, mainly due to capital gains.

Outlook and positioning



Zero rates and quantitative easing and tightening are tools that central banks have never used until recently. As a result, it appears they are not confident enough when applying or withdrawing these policies, leading to inconsistencies, potential policy mistakes and investor anxiety.

Some investors may be concerned by the fact that the yield curve is now inverted (shorter-term interest rates are higher than longer-term rates), as this has historically been a leading indicator for recession. We believe the yield curve is currently "artificially" inverted, because the front end of the curve has been affected by central banks talking down the rate outlook, but they have not followed up by actually cutting rates. On the long end of the curve, the end of quantitative tightening is effectively killing supply, and it is not hard to imagine that those long-term bonds are getting aggressive bids.

The Fed and the Bank of Canada will likely fulfill their "promise" by cutting interest rates within the next six to 12 months. Depending on how impatient investors get, we may see a stock market correction like the one we had in November and December to motivate central banks to deliver sooner.

We recognize this will not be a typical late economic cycle as long as government and central banks continue to interfere to prolong it. Interference leads to short-term gain but long-term pain, as we are effectively borrowing growth from the future. Central banks have not asked the question of who actually needs bailouts. Is it companies that pay large dividends and buy back shares, or are they companies with broken business models that cannot afford marginally higher rates? Letting them survive does not make sense if you ask us.

Canadians are obsessed with marijuana and investors love the roller-coaster ride of the share prices of cannabis companies. One of the largest players, Canopy Growth, has a market capitalization of $20 billion, although it is hard to judge how much it is worth since it has not had positive earnings. Those who love it say it is a unique business and has a large potential consumer base. We can only comment on the relative comparisons. Using Loblaw Companies Ltd. as an example, it likely has a larger consumer base, has a proven track record and is worth $24 billion, yet Canopy will probably be worth more than Loblaw this year based on its current momentum. Those who owned Loblaw and not Canopy were “underperformers” in this market.

We will adjust our portfolio positioning when justified by changing valuations and policies, including overweighting equity at a time when economies are slowing and earnings are declining. We were defensive at the end of 2018 and turned bullish after the Fed pivoted from hiking to cutting. It was an important event and the market performance speaks for itself. We do not mind owning more quality stocks and less bonds on occasion (a more aggressive asset mix), but we do not trade quality for speculation. It is a process that explains how we survived all the previous booms and busts.

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Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns net of fees and expenses payable by the fund (except for figures of one year or less, which are simple total returns) including changes in security value and reinvestment of all dividends/distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

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