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GLOBAL ASSET MANAGEMENT™

# Signature Dividend Fund
# Second-quarter 2020 Commentary

| Class F returns (in %) as at June 30, 2020 | Year-to-date | 1 year | 3 year | 5 year | 10 year | Since inception (2001-09-28) |
|---|---|---|---|---|---|---|
| Signature Dividend Fund | -11.6 | -6.6 | -0.4 | 2.1 | 6.2 | 5.6 |

Source: Signature Global Asset Management, as at June 30, 2020.

**Performance Summary**

- Over the quarter ended June 30, 2020, Class F of Signature Dividend Fund (the Fund) returned 10.8% while its new blended benchmark (40% MSCI ACWI Global High Dividend Yield Total Return Index, 35% S&P/TSX Preferred Share Total Return Index and 25% S&P/TSX Composite Total Return Index) was up 11.6%. (The old blended benchmark had the BMO Capital Markets 50 Preferred Total Return Index in place of the S&P/TSX Preferred Share Total Return Index.)

- The Fund's owned common equities positions returned 8.7% and 15.0% from domestic preferred share holdings, generating an underlying portfolio return above 11%. The Fund's foreign investments outperformed the foreign equities portion of the benchmark, the MSCI ACWI Global High Dividend Yield Total Return Index, which was up 6.0%, in Canadian dollars. The Fund's domestic equity holdings returned 8.2% during the quarter, underperforming the S&P/TSX Composite Index, which was up 17.0% over the same period.

- The strongest sectors in the benchmark during the quarter were materials, up 31%, and information technology, up 28%. The worst-performing sectors in the benchmark were communication services and utilities. Stock selection for the Fund outside of Canada compared favourably overall with the MSCI ACWI Global High Dividend Yield Total Return Index; however, against the domestic market the Fund's lower beta positioning underperformed. With the S&P/TSX Composite Index benefiting from a doubling in the share price of Shopify Inc. and more than 50% gains in junior gold stocks, it was not a quarter for a dividend mandate, such as the Fund has, to outperform. The weakest-performing sectors for the Fund during the quarter were energy and utilities, where the Fund's positions declined 1% and gained 0.4%, respectfully. The Fund's material overweight position in the financials sector relative to the benchmark proved helpful during the quarter as economic concerns alleviated somewhat from the low levels in March 2020.

- Preferred shares, which represented approximately 41.5% of the Fund at quarter-end, had a strong bounceback from the lows in the first quarter of 2020, up 14.3%, compared with the 15.0% gain for the S&P/TSX Preferred Share Total Return Index. The Canadian preferred shares market moved higher along with all global risky assets, but have recovered only about 55% of their fall in the previous quarter due to Canadian interest rates continuing to move lower during this quarter. Rates for Government of Canada five-year bond fell 22 basis points to 0.37% during the quarter, given the weak economic outlook. Investor sentiment turned 180 degrees from the panic of March 2020, and thus preferred shares did much better. Perpetual preferred shares were the best performers, up 18.6%.

**Contributors to Performance**

- Interest in Apple Inc.'s 5G-network iPhones remains high, and the company's stock has been appreciating on higher-than-anticipated consumer demand and excitement ahead of 5G-network product launches this year. Surveys indicate continued product loyalty for Apple and positive spending intentions if Apple launches a 5G phone with comparable, yet still high, average sale prices. Apple continues to internalize product development to maintain high margins. Most recently, the company announced it would transition its computers to its own internal chip, at the expense of Intel Corp. The company's AirPods have emerged as a successful new category, outpacing the historical growth of other accessories and making a noteworthy contribution to revenue growth. The company's valuation remains attractive, and a growing total addressable market, including services, and a strong balance sheet remain supportive.

- Microsoft Corp. seems to be a noteworthy contributor to Fund performance most quarters. Despite a warning on weakness in near-term sales of personal computers, the company is seen as a relatively defensive investment in the context of the COVID-19 pandemic. Microsoft has seen a huge surge in demand for its online services, with the company noting that it has seen nearly two years of cloud-computing service adopted in just two months. This bodes well for the company's positioning with clients as engagement with cloud-computing service applications and online collaborative tools, such as Microsoft Teams, has been rapidly accelerating.

- Synchrony Financial's stock rebounded more than 37% in the quarter following the prior quarter's decline of 55%. This consumer finance company generates above-average profitability through the business cycle at the expense of higher-than-average vulnerability during downturns. As a result of the COVID-19–induced sudden economic collapse, there is dramatic uncertainty regarding U.S. unemployment levels and offsetting government support, which had collapsed the company's valuation to the lows experienced during the 2008–09 financial crisis. While we fully recognize the company's near-term earnings and capital generation are materially impaired, we see an attractive upside for Synchrony Financial as economies recover.

- Agnico Eagle Mines Ltd.'s stock appreciated more than 50% during the quarter. Part of the company's share-price strength in the quarter was a recovery from relatively poor stock performance in the first quarter of 2020 related to operational difficulties with the startup of its two Nunavut mines (Meliadine and Meadowbank) as well as a delay in the development of its LaRonde mine in northwestern Quebec due to underestimated geological complexity. These issues were compounded by the shutdown of the company's Mexican mines and reduced activity at its Nunavut and Quebec operations. With the removal of mining restrictions in Mexico and resumption of activity at its mines in Canada, Agnico Eagle Mines, a company with a traditionally good operating history and capital discipline, had good share-price appreciation as gold prices moved higher over the quarter.

- Air Lease Corp.'s stock advanced 32% during the quarter, recovering some of what it lost in the first quarter of 2020. While the company operates in an industry that is currently experiencing widespread distress and catastrophe, the company has an incredibly experienced management team, and a strong balance sheet and liquidity profile. We expect Air Lease to demonstrate resilience through the current crisis in the travel industry and for the company's valuation to re-rate and appropriately reflect attractive growth and returns generated in the firm's operations over the business cycle.

**Detractors from Performance**

- Positive stock performance was widespread during the quarter, and there is nothing to call out in regards to material absolute individual detractors from the Fund's performance during this quarter. A few Fund positions experienced relatively flat share prices, and attribution reports identify them as slight detractors when measured in Canadian dollars as the Canadian currency rallied 3.5% against the U.S. dollar and about 2% against the euro.

- Loblaws Cos. Ltd. stock declined 8% during the quarter as the company disappointed slightly on its quarterly earnings and the company's defensive attributes lost out in a recovery in investor appetite for risk.

- Total S.A., an integrated energy company, performed relatively well in the first quarter of 2020, but the company lagged this quarter. While Total's chemical and refining business has rebounded with the lifting of the COVID-19 shutdown in many European countries, the company's upside is capped by new capacities being brought online. Demand for oil products and chemicals is likely to remain below available capacity. However, the valuation for Total remains compelling, and we believe the company's dividend yield, estimated at 7.5%, is well covered at Brent crude oil prices of US$40-45.

- Budweiser Brewing Co. APAC Ltd.'s stock advanced over the quarter; however, we exited the Fund's position in the company in early April at a loss, rendering the Fund's position as a modest detractor from performance during the quarter.

- Marathon Petroleum Corp.'s stock advanced during the quarter; however, our poorly timed decision to give up on the company in mid-April rendered the Fund's position in the company as a modest detractor from Fund performance for the quarter. Energy demand suffered severely with the COVID-19–induced economic shutdown, and our macroeconomic outlook for a rather soft economic recovery supported our decision to reduce the Fund's cyclical exposures. A mild economic recovery is unlikely to support a return to a normalization of demand, leaving Marathon Petroleum with a challenging margins outlook.

**Portfolio Activity**

- In the financials sector, we reduced the Fund's foreign exposures as the sector rallied and we added to domestic financials, taking overall financial sector exposure up slightly. We sold SVB Financial Group, a top-performing U.S. bank, and reinvested proceeds from its sale in the Fund's slightly cheaper domestic banks. We also exited Fund positions in Brightsphere Investment Group Inc., Morgan Stanley, Banco do Brasil S.A., East West Bancorp Inc., Banco Santander S.A. and India's ICICI Bank Ltd. Additions to domestic financial positions included The Toronto-Dominion Bank, Canadian Imperial Bank of Commerce, Bank of Montreal, Fairfax Financial Holdings Ltd., The Westaim Corp. and Industrial Alliance Insurance and Financial Services Inc.

- In the consumer discretionary sector, we exited the Fund's position in Budweiser Brewing Co. APAC in early April, believing the company's share price had held up too well given the anticipated impact of COVID-19 on the company's revenue, especially the company's nightlife business, which accounts for 30% of revenue and is a higher-margin business. Competition also launched a few new products in the premium and super-premium beer segments, which would hurt Budweiser Brewing Co. APAC in those segments. We also sold Loblaws and reallocated proceeds from that sale to various foreign consumer discretionary sector positions. The outlook for Loblaws is favourable, but we believe we can do better with the Fund's holding of global companies in the consumer staples sector.

- In the health care sector, we sold the Fund's holding in Becton, Dickinson and Co. in late April. The company pursued an inordinate capital raise, which weakened our confidence in the company's new management team. While the need to do some level of issuance did make sense with elective medical procedures coming to a standstill as hospitals allocated limited resources toward treating COVID-19 patients, the ultimate use of proceeds was unclear. To us, this increased the risk of new management undertaking large-scale mergers and acquisitions at a time when management should be focused on strengthening the company's core business. In June, we bought shares of Bristol-Myers Squibb Co., a company in which we see a clearer path of re-rating potential. With Bristol-Myers Squibb, we believe investors have underestimated the value of its drugs-in-the-pipeline assets and potential upside if the upcoming Eliquis patent ruling is favourable for Bristol-Myers Squibb. The company's current valuation seems to suggest an adverse outcome is likely, rendering the current risk/reward opportunity for buying the company's stock as attractive.

- We increased the Fund's exposure to the industrials sector during the quarter. We added a modest Fund position in Waste Management, Inc., which trades at a demanding valuation that is supported by a relatively resilient business, with some parts of the business being oligopolistic. In addition, we acquired a position in Sweden-based Atlas Copco AB, a leading industrial equipment producer. The company has a track record of generating good shareholder value with well-executed capital deployment and a strong balance sheet. Atlas Copco has been adapting to the new world successfully by digitizing repair businesses and enhancing services.

- The Fund's weight in the utilities sector declined materially during the quarter as we trimmed Fund holdings in the sector as the sector lagged the broader market. We sold Tokyo Gas Co., Ltd. after it staged a good share-price recovery after a disappointing first quarter of 2020. The company's stock recovered to reach our reduced fair-value estimate, and so we exited the

Fund's position in the company. We added Entergy Corp. following a period of underperformance for the company's stock. Entergy is a pure-play utility that has not yet been re-rated for the low rate environment relative to the company's higher-quality peers in the U.S. Entergy's growth is above average, and we see good room for multiple expansion of the company's stock. We chose to trim the Fund's utilities weight and take equity beta up slightly and selectively as the Fund portfolio's large preferred shares exposures offer sufficient defensive attributes.

- The Fund's weights in the energy and materials sectors were reduced as the Fund's holdings in Exxon Mobil Corp. and Marathon Petroleum were each sold in order to reduce cyclical exposures given the poor economic outlook for such energy companies. In addition, we sold Galp Energia SGPS S.A. and reinvested a portion of the proceeds from that sale into buying shares of Suncor Energy Inc., a company where we saw a slightly better risk/reward opportunity.

- Fund positions in the information technology sector performed strongly in the quarter, and the Fund's positions in the sector were trimmed as some company valuations became tougher to justify in a dividend mandate. We a Fund position in Intel during the quarter as the company's valuation seemed relatively attractive.

**Outlook**

- The current macroeconomic environment is characterized by extreme uncertainty. The COVID-19–induced global economic shutdown is unprecedented. Government income and liquidity support universally has also been unprecedented. Financial conditions have been eased everywhere, materially, and banks are providing material loan forbearance. Retail investor equity engagement has exploded. Interest rates globally are extremely low or negative. The cost of capital appears surprisingly low on average, with extreme bifurcation by sector and geography.

- Stock markets have rebounded strongly from March 2020 lows. Per the Bloomberg World Exchange Market Capitalization Index, the value of equities globally crashed from US$89 trillion to US$61.6 trillion from January 20 to March 24, 2020 and rebounded to above US$80 trillion by the end of June 2020. As the time of writing, we are back to US$84 trillion. Clearly, government support has avoided the worst-case scenario the markets had prepared for in March; however, there has been truly horrific damage in some sectors and households that should warrant some greater discount to January highs than appears to exist when looking at the overall markets.

- Large digital businesses have benefited from the work-from-home environment. Their growth has accelerated and their cost of capital declined, supporting record valuations and market capitalizations. It is difficult to have a positive equity market outlook at this juncture with extremely high economic uncertainty, increasing political risk in the U.S. and the inevitability of incremental tax increases to fund current support programs. Yet extreme bifurcation across equity sectors and geography does exist, providing fertile grounds for good stock selection, geographic allocation and sector allocation to drive attractive equity returns relative to the paltry fixed-income opportunities available. It seems there are parts of the markets that should be sold due to excessive optimism and other parts that suffer from excessive pessimism that should be bought, and we will do our best to act accordingly, with informed judgment.

- Looking out over the next six to 12 months, we remain positive about the Canadian preferred shares market as we believe the high current yield of 6.25% is attractive in what will be a low-yielding world for a number of years. However, we have begun to reduce the Fund's overweight position in preferred shares as they have improved and we see better opportunities elsewhere. Issuance will be very low, and investor sentiment is expected improve from low levels. Most of the liquidity premium associated with preferred shares has diminished, but there are certainly some issuers that are suffering more than others. The Canadian preferred shares market will likely remain volatile as the Canadian economy recovers and retail investors remain tentative towards the market.

Sources: Bloomberg Finance L.P. and Signature Global Asset Management.

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