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GLOBAL ASSET MANAGEMENT™

Signature Canadian Bond Fund
Second-quarter 2020 Commentary

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Class F returns (in %) as at June 30, 2020	Year-to-date	1 year	3 year	5 year	10 year	Since inception (2000-08-08)
Signature Canadian Bond Fund	7.6	7.6	4.7	3.5	3.9	4.6

Sources: Bloomberg Finance L.P. and Signature Global Asset Management as at June 30, 2020.

Performance Summary

- Signature Canadian Bond Fund Class F (the Fund) returned 6.9% over the second quarter of 2020. Over the same period, the Fund outperformed its benchmark, the FTSE Canada Universe Bond Total Return Index, which returned 5.9%.

- The positive total returns for both the Fund and the benchmark were due to the tightening of corporate bond and provincial government bond spreads relative to Canadian government bonds.

Contributors to Performance

- An overweight exposure to Canadian and U.S. investment-grade corporate bonds contributed to the Fund's total and alpha returns. Improving global risk sentiment as economies began to re-open post-COVID-19 lockdowns, as well as the launch of monetary policy credit programs from both the Bank of Canada and the U.S. Federal Reserve (the Fed) encouraged investors to re-engage credit and risky assets.

- An overweight exposure to provincial and municipal government bonds added to the Fund's total and alpha returns. Provincial and municipal spreads tightened alongside other investment-grade spreads, as investor global risk sentiment rebounded throughout the second quarter and the Bank of Canada launched a provincial bond purchase program, providing relief against ballooning provincial fiscal deficits and debt burdens.

Detractors from Performance

- An underweight exposure to Canadian interest rates relative to an overweight exposure to U.S. interest rates detracted from alpha returns, as Canadian interest rates fell throughout the quarter, while U.S. interest rates were unchanged.

- An allocation to U.S.-dollar denominated bonds, net of currency hedges, modestly detracted from both the Fund's total return and alpha return. A rebound in oil prices and general risk sentiment throughout the second quarter saw pro-cyclical currencies, including the Canadian dollar, outperform safe-haven currencies such as the U.S. dollar.

Portfolio Activity

- As global risk sentiment improved throughout the second quarter, overweight exposures to Canadian and U.S. corporate bonds, as well as provincial and municipal government bonds, were substantially increased, mostly through participation in new issues.

- Purchases of U.S. agency mortgage-backed securities (MBS) were among the Fed's initial monetary policy responses in March, which saw MBS spreads tighten meaningfully by the start of the second quarter. As opportunities arose to purchase corporate bonds, the Fund's MBS exposure (just over 4%) was sold in April to raise the required cash.

- Alongside the significant increase to credit risk, the fund's duration exposure (interest rate risk) was increased to diversify its active risk. This was accomplished by buying 5- to 10-year government bonds from cash and 2-year government bonds.

Outlook

- Although the initial fiscal and monetary responses to the global pandemic were swift, decisive and effective, more policy support is expected in the coming months. Accommodative policies must remain in place for the next several years to help economies close their output gaps. If economic lockdowns will not be implemented again, even against a backdrop of a resurgence of COVID-19 cases, it could take the U.S. and Canadian economies up to three years to recover to 2019 GDP levels. Premature tapering of fiscal and monetary stimulus poses a risk to economic recoveries in North America and abroad.

- As debt levels climb higher from already elevated levels (pre-pandemic), ratings agencies are putting governments (sovereigns and sub-sovereigns) on negative watch or downgrading them. Fitch recently downgraded issuer ratings for the government of Canada and the province of Alberta. The market response has been limited as debt burdens have deteriorated across the world, and as real interest rates have collapsed to zero or negative globally. With monetary policy expected to remain accommodative for the next several years, governments will be able to continue funding their debts at little to no cost despite ratings changes.

- Energy prices have rebounded alongside supply cuts and the initial sharp demand recovery in the late second quarter. However, looking ahead, the demand recovery is expected to wane as the economic re-openings are accompanied by increases in COVID-19 case counts in Canada, the United States and other countries. Given the sharp contractions in capital expenditures (30-40%) from major North American oil producers earlier this year, supply is likely to remain on the lower end providing pricing support to the energy market and, in turn, some relief to the commodity producing provinces.

- As we expected, longer maturity (10- to 30-year) government bonds have maintained their negative correlation with risky assets throughout the second quarter and this relationship is expected to persist. However, we maintain the view that short-to-medium-term government bonds (up to 10 years to maturity) will not be able to generate high positive returns if risky assets fall once more. Therefore, cash, foreign currencies, commodities and derivatives will grow in importance as defensive asset classes. Meanwhile, investment-grade corporate bonds will provide some much-needed carry and we expect investor appetite to remain strong for the foreseeable future.

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

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