Market Commentary
Fourth Quarter 2018

SIGNATURE GLOBAL ASSET MANAGEMENT™

Signature Canadian Balanced Fund

Performance summary

- In the fourth quarter, Signature Canadian Balanced Fund (Class F) returned -8.5%.

Contributors to performance

- Loblaw Companies, the large Canadian supermarket chain, was a positive contributor, thanks to its announced spinout of its 62% share of Choice Properties REIT, the real estate property name that holds Loblaws grocery stores and other real estate assets. George Weston, who owns 50% of Loblaws, will own 62% of Choice Properties REIT.

- In the fixed-income portion of the fund, government credit exposure and Canadian duration positioning contributed to performance, while corporate credit exposure detracted.

- Duration and yield curve positioning added to portfolio alpha, stemming from our overweight duration position in 7-year to 10-year maturity Canadian bonds relative to longer maturities in the fund, and a decreasing overall duration position, as interest rates fell and the yield curve steepened during the reporting period. The Government of Canada 10-year bond yield fell by some 46 basis points over the quarter, while the 10-year to 30-year segment of the yield curve steepened by 22 basis points in the same timeframe. Government credit exposure was also alpha accretive, as spreads in this sector widened 16-20 basis points across the curve during the quarter.

Detractors from performance

- In energy, Encana, the large Canadian exploration and production (E&P) company operating in both Western Canada as well as the Permian in Texas, was a detractor from performance. The Permian remains one of the most prolific of the shale oil regions in the U.S. The drop in oil prices was the source of the weak performance but we believe oil will rebound in 2019 as supply is curtailed and demand remains stable. Ultimately, our long-term positive outlook for oil prices resides around the underinvestment of the last five years on a global level.

- In financials, The Bank of Nova Scotia was a detractor because of its meaningful emerging market exposure. The resulting fall in emerging markets, generally, negatively impacted the Bank of Nova Scotia disproportionately relative to many other Canadian financials.

- Citigroup was another detractor given its large international exposures as well. Over half of Citigroup's revenues are from outside the U.S.
- Corporate credit exposure was a drag on performance, as spreads widened in this sector. Canadian investment-grade corporate credit spreads widened by a substantial 33 basis points over the quarter.

Portfolio activity

- In the quarter, we added Banco Santander, Spain's largest bank and one of Europe's largest. We like Banco Santander because Spain is well past the 2008 crisis with decent growth rates and operates a more consolidated banking sector. We believe the end of quantitative easing in Europe will see higher levels of interest rates, benefiting bank margins. Longer term we also like Banco Santander's emerging market exposure, which we do not believe is fully priced into their shares. Banco Santander is inexpensive with a healthy and sustainable dividend yield.
- We also added to Tourmaline Oil, the Canadian exploration and production company with a prominent presence in Western Canada. We like the business model of the company with its growth profile at an attractive long-term valuation. We were admittedly too early in making this position but have confidence in the management team, which has a long-term track record.
- In the quarter, we eliminated our position in Micron Technology, manufacturer of semiconductors including DRAM and SRAM memory chips. This was the result of lowering the weight in technology, which began this past summer. The semiconductor industry is very linked to global growth. The continued global slowdown, combined with the China–U.S. trade war, led us to further take down our technology weight, and Micron was the more economically and cyclically challenged.
- We added to duration gradually in the 10-year area of the yield curve amid the shift lower in longer-term interest rates. We also increased our yield curve steepening exposure by selling duration-equivalent quantities of 30-year government bonds in favour of 10-year bonds. Our concern was that the fall in energy prices, tightening financial conditions and trade tensions between the U.S. and China would have a dampening effect on the Canadian economy, compounding the influence of an emerging slowdown domestically and abroad, and limiting scope for the Bank of Canada to raise interest rates, prompting a steepening of the yield curve.

- We reduced our exposure to U.S. inflation-linked bonds and shifted the associated duration exposure back to the Canadian market as energy prices fell and the prospects for near-term inflation soured. In addition, our low exposure to government credit was maintained amid concerns that budgetary deficits and borrowing requirements of various levels of Canadian governments would rise in an environment of softer economic activity, leading to wider credit spreads in this sector.

Market outlook

- The last quarter was one of the worst on record for equity markets, and we enter 2019 with very oversold conditions. The market appears to be anticipating a significant economic slowdown, but we do not expect a U.S. recession in 2019 as the consumer remains healthy, employment growth remains strong, wages are now growing over 3%, and jobs are plentiful. Recent market moves confirm that the U.S. is not immune to a global slowdown and its equity market has caught up to the rest of the world.

- Prospects for additional rate hikes by the Bank of Canada have eroded, with markets pricing in less than one 25-basis-point increase over the next year. The collapse in energy prices, tightening financial conditions and trade tensions between the U.S. and China are seen slowing the economy and dragging inflation below the 2% target of the Bank of Canada.

Class F Returns (in %) as at December 31, 2018	Year-to-date	1 year	3 year	5 year	10 year
Signature Canadian Balanced Fund	-7.4	-7.4	3.0	4.2	7.1

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The comparison presented is intended to illustrate the mutual fund's historical performance as compared with the historical performance of widely quoted market indices or a weighted blend of widely quoted market indices. There are various important differences that may exist between the mutual fund and the stated indices that may affect the performance of each. The objectives and strategies of the mutual fund result in holdings that do not necessarily reflect the constituents of and their weights within the comparable indices. Indices are unmanaged and their returns do not include any sales charges or fees. It is not possible to invest directly in market indices.

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