Market Commentary
Fourth Quarter 2018

CI Canadian Small/Mid Cap Fund

The portfolio of the fund is divided among three sub-advisors: Picton Mahoney Asset Management, Manulife Asset Management, and QV Investors Inc. The comments below pertain to each sub-advisor's portion of the portfolio.

Picton Mahoney Asset Management

An ominous mile marker was passed in the fourth quarter as most global equity markets are either in, or approaching, bear market territory (a 20% correction from highs). For most of the quarter, there was massive sector rotation with profit-taking on longtime sector winners (information technology, industrials) in favour of defensive sectors. Driving this rotation was concerns on global growth as fewer economies are in expansion as the breadth of PMIs (a leading indicator on manufacturing activity) has fallen below 75%, to the lowest level in years. The divergent growth path of the U.S. versus the rest of the world has created unintended risks, as the pace and vigor of U.S. interest rate hikes strengthened the U.S. dollar. A strong dollar acts as a brake on global growth and a delicate balance was in place given volatility in emerging markets. Not so quietly, this balancing act shifted during the quarter, driving equity markets lower.

Our positioning in underweight energy and overweight health care added to performance. Top-performing holdings were Tamarack Valley Energy and Birchcliff Energy. Our positioning in underweight materials and underweight utilities detracted from relative performance. The largest individual detractors were ATS Automation Tooling Systems and SSR Mining.

We continue to believe that the U.S. economy has reached the later stages of the cycle and the ongoing strength in the U.S. economy is forcing a tightening cycle that the rest of the world may not be able to afford. With the U.S. Federal Reserve Board's (Fed) focus on raising rates to normalize liquidity, they may be underestimating the impact of deteriorating global growth. By the time the impact is felt within the U.S. economy, it could be too late to right the course of the global economy. However, if the Fed acknowledges stresses around the globe and pauses the rate hike cycle, equity markets should react favourably as evident in past cycles.

Manulife Asset Management

For the three-month period ended December 31, 2018, CI Canadian Small/Mid Cap Fund underperformed its benchmark, the S&P/TSX Small Cap Index. Within the index, the top-performing sectors were utilities, materials, and health care, which delivered returns of -1.9%, -3.3%, and -5.7%, respectively. The bottom-performing sectors were energy, industrials, and consumer discretionary, which delivered returns of -33.5%, -17.0%, and -15.6%, respectively.

In the fourth quarter, the Canadian small capitalization equity market declined along with equities around the world as investors became increasingly defensive amid concerns about equity valuations, slower earnings growth, rising interest rates, and trade wars impacting economic growth. The energy sector was weak as a result of the ongoing takeaway capacity issues in the Canadian energy market, as production increased and the discount between Western Canadian Select and West Texas Intermediate reached a high of more than US$40 per barrel over the quarter. The top-performing sectors were the defensive-oriented areas of utilities as well as materials, as the result of a safe-haven rally in gold prices.

Over the quarter, both sector allocations and security selections detracted value on a relative basis versus the Index. The top negative sector contributors were the portfolio's underweight allocations to materials and real estate. A sector overweight in utilities added value in the portfolio. On an individual security level, the top positive contributors were both within the resources area. The top negative contributor was the portfolio's overweight position in an energy company.

Over the past several years, strong equity returns have been driven by healthy corporate fundamentals, U.S. tax reform, low inflation, and stimulative interest rates. Recent market volatility is not indicative of poor fundamentals, but investors have turned defensive as the result of fewer positive equity catalysts, slower economic growth, and lack of confidence in geopolitical leadership. We believe this change in investor sentiment is owing to less fiscal stimulus, rising interest rates, higher inflation data, slower growth in corporate earnings, and the trade war between the U.S. and China. In addition, markets have already priced in slower global economic growth and there are growing concerns that world leaders lack the political will to get the economy through the current soft patch.

Our overall outlook is cautious, and we will be closely watching the macroeconomic landscape, specifically the Fed and the trade relationship between the U.S. and China, to gain some clarity on the global economy. There are several important events over the first quarter of 2019, including the U.S.-imposed deadline of March 1 to reach a trade deal with China and the Fed's March interest rate announcement, which may have the ability to increase market volatility given the potential ramifications of these events.

At the end of the quarter, the portfolio held sector overweight positions in industrials, information technology, and utilities, and underweight positions in materials (owing to an underweight position in gold stocks), real estate, and health care. In addition, the portfolio has maintained a zero weight in the communication services sector and has increased its cash equivalents to 7.2%.

QV Investors Inc.

Weak performance during the quarter was broad based, but particularly acute in the oil and gas sector with oil and Alberta-based natural gas production falling precipitously. The fund's energy investments outperformed the benchmark sector, and the strategy's focus on cash-generating businesses within cyclical areas and less valuation risk than the market contributed to relative outperformance. The fund's lack of direct gold exposure detracted from relative returns. The gold sub-sector advanced in the period due to the metal's perceived safe-haven status during challenging markets.

The strategy's top contributing investments were Empire, ATCO, and Alleghany. The largest detractors were AltaGas, Canadian Western Bank, and ARC Resources.

At quarter end, Canadian holdings represented 78.6% of the portfolio and American holdings represented 15.3%. Cash comprised 6.1% of the portfolio. The fund consists of 33 investments, of which 26 are Canadian domiciled and seven are U.S. based.

During the quarter, we initiated an investment in IGM Financial, the largest independent asset manager in Canada, at a multi-year low valuation. Lower valuations across the space have been driven by fears that growth in exchange-traded funds will begin to result in sustained net outflows of assets for active managers, and concerns over fee compression in the asset management industry. IGM has a conservative balance sheet and generates strong cash flow that it largely pays out in the form of dividends. IGM is additive to the fund's valuation and balance sheet metrics.

The fund exited its positions in Maxar Technologies and Ampco-Pittsburgh. Although Maxar has a strong legacy as a leader in the Canadian technology space, the company has failed to address heightened debt levels since it made a major acquisition last year. A failure to address balance sheet leverage risks the company's long-term competitive positioning. Despite the value in the Ampco-Pittsburgh business, the position was exited because of uncertainty in the short and medium outlook due to trade concerns. We became increasingly concerned by what we perceived to be aggressive use of the balance sheet, further putting equity investors at risk.

The strategy has weathered numerous market and economic cycles by owning a diversified portfolio of businesses that exhibit above-average profitability and below-average valuations relative to the benchmark. This discipline persists.

Valuations of growth-oriented and expensive high-quality businesses have pulled back with the recent market weakness and less-than-perfect company execution. We remain focused on businesses that can execute their strategies in challenging periods, with the ability to improve their franchises without relying on exogenous factors. Portfolio cash provides ample dry powder to deploy capital as opportunities develop.

The strategy provides higher income generation, a lower estimated payout ratio and stronger balance sheet metrics than the average small to mid-cap company, which should all contribute to downside support in a more challenging market environment.

Market Commentary
Fourth Quarter 2018

Class F Returns (in %) as at December 31, 2018	Year-to-date	1 year	3 year	5 year	10 year
CI Canadian Small/Mid Cap Fund	-12.0	-12.0	3.0	2.5	9.8

Published January 2019.