Market Commentary
Third 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

The third quarter of 2018 was marked by an escalation of trade tensions as the Trump administration's rhetoric was felt in various geographies and jurisdictions. To the extent NAFTA negotiations had dragged on, the quarter ended with resolution in the form of the United States-Mexico-Canada Agreement ("USMCA") trade pact. Given what was at risk for Canada, the details of the agreement appeared to come out far better than wide-scale punitive tariffs, which were threatened over much of the past year.

In broader macroeconomic trends, for some time now we have noted divergences in the global synchronized growth narrative that was prevalent in 2017. The U.S. economy seems to be firing on all cylinders, while many developed and emerging economies worldwide have been exhibiting some unease in marching along the rate hike path that the U.S. Federal Reserve Board seems to have set. Canada, for its part, has exhibited some decent headline economic performance, but structural challenges remain, leaving our equity market lagging global peers. Late cycle dynamics (i.e., inflation impulse) do not appear to be rewarding Canada to the same degree they would have historically, and this has been evident in smaller cap issuers.

To the extent the period ended with up-trending energy prices, one would expect smaller issuers to dramatically outperform their large cap peers (i.e., a beta move), but this was not the case, as performance was roughly matched between large and smaller TSX energy sectors. Examples like this reinforce our view that Canada offers managers focused on active share an opportunity to outperform.

Our positioning in materials and industrials added to performance. Top performing holdings were Parkland Fuel (PKI) and Cargojet (CJT). Our positioning in health care slightly detracted from performance. The largest individual detractors were Aimia (AIM) and Endeavour Mining (EDV).

As we approach year-end, we continue to believe that Canada, at the very least, represents a stock picker's market, where active share is an attribute to be sought after. Progressively, as the world bides time until the next global recession, Canada will continue to exhibit risks largely attributable

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to structural deficiencies in our economy, not the least of which is the impact of rising interest rates on consumption, which has been long aided by wealth effects from housing gains. Beyond this, and for reasons noted above, we do not see a compelling reason to substantially overweight resource sectors, given our views that Canada does not seem poised to benefit from late cycle impulses (i.e., inflation) to the degree it would have in prior cycles.

Manulife Asset Management

In the third quarter, the Canadian equity market declined as a result of weak commodity prices and ongoing economic uncertainty caused by the U.S. trade wars. Within the materials sector, gold prices were down over the quarter as the strength of the U.S. economy prompted another interest rate increase by the U.S. Federal Reserve Board, causing the U.S. dollar to appreciate and gold stocks to decline. Base metals stocks were also weak, as U.S. tariffs and a slowdown in China's manufacturing data caused copper and zinc prices to decline. The energy sector weakened as a result of volatility in oil prices, as West Texas Intermediate oil prices started the quarter near US$75 per barrel, declined to US$65 per barrel, and recovered to US$75 per barrel at the end of September.

Also, the uncertainty surrounding North American Free Trade Agreement ("NAFTA") negotiations between the U.S. and Canada weighed heavily on the Canadian equity market over the quarter. However, as the period came to a close and the U.S.-imposed NAFTA deadline approached, the U.S., Mexico, and Canada announced that they had reached a new trilateral trade deal called the USMCA.

Over the quarter, both sector allocations and security selections contributed to the strategy's performance. The top sector contributors were the portfolio's allocation to materials and industrials. On an individual security level, the top contributors were both within the resources area.

Sector allocations in financials and real estate detracted from performance in the portfolio. The top detractor was the portfolio's overweight allocation in a non-benchmark holding specialty food manufacturer. The benchmark is a combination of the S&P/TSX Completion Total Return Index – 50% and the S&P/TSX SmallCap Total Return Index - 50%.

Although equity markets were still assessing the new trade deal as the fourth quarter began, we believe the fact that a new deal is in place is constructive for Canadian equities. With a deal now in place with Mexico and Canada, the U.S. may focus more attention on its trade relationship with China.

We believe fundamentals within the Canadian equity market are positive: earnings are expected to grow at a robust rate in 2019 and valuations appear reasonable. We believe the combination of healthy equity fundamentals and the removal of NAFTA uncertainty should increase investor demand for Canadian equities. We are constructive on the outlook for late-cycle cyclicals and favour industrials stocks, energy producers, and the information technology sector. Overall, we are cautiously optimistic and believe equity markets are not pricing in a recession anytime soon. Our cyclical positioning could shift to become more defensive if warranted, but we do not believe the equity markets are at that inflection point.

QV Investors Inc.

The fund's allocation to materials and lack of exposure to the gold space, in particular, contributed to outperformance. The fund's energy holdings also performed well, advancing over 10% in the quarter. Stock-specific pressure within utilities and industrials detracted from relative performance. The largest negative contributors were AltaGas and Maxar Technologies. Shares of AltaGas have been under significant pressure since the company's acquisition of WGL Holdings earlier this year. Increased leverage and uncertainty regarding asset sales have weighed heavily on investor sentiment. While the current performance of the shares is disappointing, the manager believes the company has several options that will allow it to maintain a strong balance sheet while demonstrating the cash-generating capabilities of its quality asset base. Shares of Maxar responded negatively to a short seller's report released in August. While the manager disagrees with the short seller's thesis, Maxar has put itself in a vulnerable position with record levels of debt during a trough in the satellite market. Today, the shares are trading at a wide discount to comparable companies, while providing services with strong competitive barriers. Combined, these two companies detracted 2.2% in the quarter. The strongest individual contributors to fund performance over the quarter were Parkland Fuel, Secure Energy Services, and Alleghany.

During the quarter, we initiated investments in ARC Resources, Element Fleet Management, and Linamar. ARC Resources is an oil and gas producer focused in Western Canada. The company has a strong asset base and record for growing production per share without excessive use of leverage. Weak natural gas prices and transportation constraints allowed us to purchase the company at an attractive valuation. Element Fleet Management is North America's largest fleet leasing company. Following a period of significant challenges, the company recently appointed a new CEO with a solid record of sound execution and cost management. With its strong cash flow as a foundation and new leadership in place to improve the business's operations and capital allocation decisions, we believe this is a sound investment for long-term shareholders. Uncertainty surrounding ongoing trade negotiations has pressured shares of auto parts manufacturer Linamar this year. The company has a long track record of double-digit returns on invested capital and book value per share growth.

The fund exited its positions in New York Community Bancorp, NOW, and Wabtec. New York Community Bancorp did not live up to expectations in managing its business. While the shares offered an attractive dividend yield, management has been less than effective at growing earnings, so we decided to look for better opportunities. Recent share price strength in NOW allowed us to reduce our overall exposure to oil and gas related equities. Shares of Wabtec were sold on strength following the announcement of a large proposed acquisition.

Stocks exhibiting growth and momentum continue to exhibit strong performance, often to the detriment of value investments. In this environment, we remain focused on businesses with solid underlying fundamentals and adequate margins of safety. Although some of these businesses are currently out of favour, continued improvement of these franchises should benefit the strategy over time. While sentiment on Canadian markets has generally been negative, recent developments on major infrastructure projects and trade negotiations may ease investor uncertainty and spur incremental business investment.

The strategy provides better valuation characteristics, a higher yield, and stronger balance sheet metrics than the average Canadian small/mid cap company, which should all limit the impact of a decline in a more challenging market environment. Continued growth in dividends supported by earnings growth should also help to offset potential negative implications from inflationary pressures and higher interest rates.

Class F Returns (in %) as at September 30, 2018	Year-to-date	1 year	3 year	5 year	10 year
CI Canadian Small/Mid Cap Fund	3.3	8.7	9.9	7.9	9.6

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