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CI Multi-Asset Management

### Market performance

2018 was a turbulent year for stock markets. The year started strong with most equity indexes reaching new highs in the first quarter. The S&P 500 Index had the strongest momentum, gaining over 11% year-to-date as of September 20, 2018. However, it finished the year with a return of -4.4%. A similar pattern could be found across other equity indexes. Compared to 2017, there were also wider daily and intra-day moves. In 2018, there were 32 instances where the S&P 500 Index lost more than 1% on a daily basis, compared to only four instances in 2017.

Those who expected bonds to provide better returns were also disappointed. The FTSE Canada Universe Bond Index reported a loss from a price perspective – with the inclusion of income, the index gained 1.4%. The gain was attributed to a final quarter rally. Given losses across the board in equity markets and a very mediocre result from bonds to offset, most investors did not earn a positive return in 2018.

Currency markets were volatile. Domestically, North American Free Trade Agreement (NAFTA) negotiations and weaker oil prices caused the Canadian dollar to perform poorly. The U.S. dollar finished the year on a high note as investors sought safe havens in December when stocks sold off on liquidity and confidence issues. The U.S. dollar gained 8.5% against the loonie in 2018. This helped turn the performance of many U.S. investments from negative to positive for Canadian investors.

Returns in % at December 31, 2018	3 months	1 year	3 years	5 years	10 years
S&P/TSX Composite Index	-10.1	-8.9	6.4	4.1	7.9
S&P 500 Index (C\$)	-8.9	4.0	8.7	14.0	14.4
MSCI World Index (C\$)	-8.6	-0.2	6.4	10.5	11.5
FTSE Canada Universe Bond Index	1.8	1.4	1.9	3.5	4.2

Source: Bloomberg, FTSE

### Portfolio performance

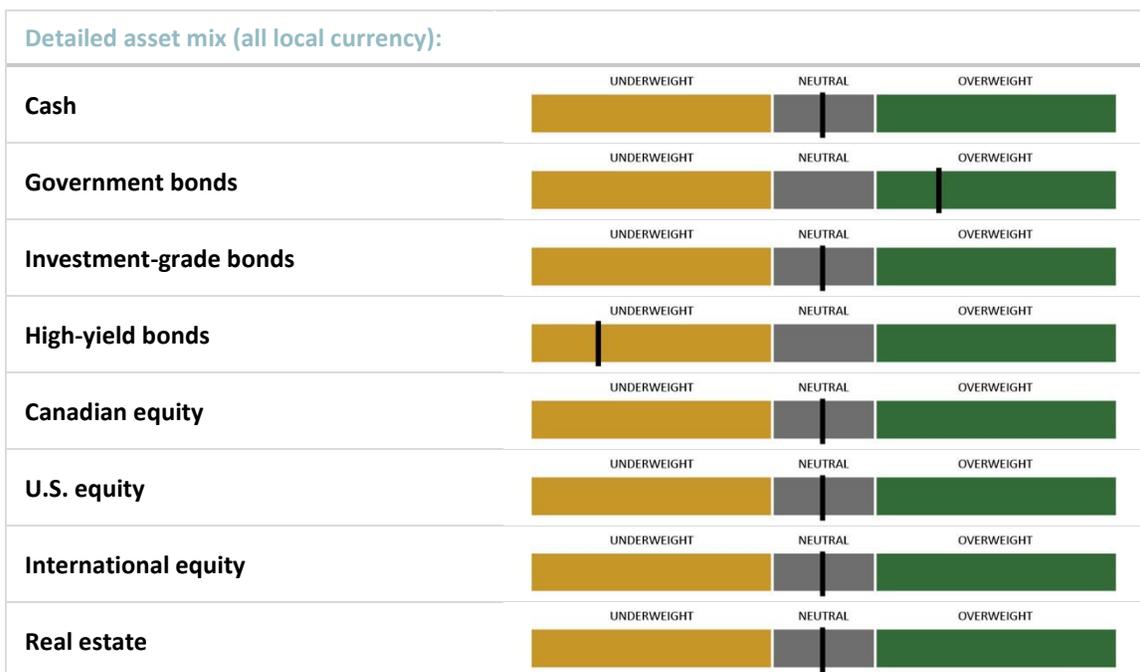
2017 was an outlier year in which investors could earn a return in almost all investments thanks to growing money supply, U.S. tax cut announcements and generally upbeat tones. 2018 was also an outlier year in which investors lost money in almost all asset classes as high expectations met reality, even though the reality was not that bad. We have had two unusual years because of central bank policies and investor sentiments. We recognize that holding investments with a quality bias and attractive valuations were out of favour in both years and caused our performance to suffer. Market corrections are painful to watch, but they also flush out speculators and create a healthier investing environment. This process will likely continue for most of 2019 and we expect to see attractive opportunities again soon.

Volatility and drawdowns in the portfolios were low during 2018, which is attributed to our defensive positioning. Bonds rallied in the fourth quarter and we participated. Our market hedge strategy using derivatives also added value. However, our U.S. dollar hedge, based on the thesis that U.S. twin deficits would eventually put pressure on the U.S. dollar, did not play out in 2018 and was a detractor. Portfolio Series Balanced Fund (Class F) finished in the first quartile for the 10-year period as of December 31, 2018, as reported by Morningstar.

Returns in % at December 31, 2018 (Class F)	3 months	1 year	3 years	5 years	10 years
<b>Portfolio Series Income Fund</b>	-0.5	-1.0	2.6	4.3	6.8
<b>Portfolio Series Conservative Fund</b>	-2.0	-1.4	2.5	4.4	6.9
<b>Portfolio Series Conservative Balanced Fund</b>	-3.6	-2.4	2.8	4.7	7.3
<b>Portfolio Series Balanced Fund</b>	-4.8	-3.4	3.1	5.0	7.6
<b>Portfolio Series Balanced Growth Fund</b>	-6.4	-5.2	3.2	4.9	8.0
<b>Portfolio Series Growth Fund</b>	-7.3	-5.6	3.3	5.1	8.3
<b>Portfolio Series Maximum Growth Fund</b>	-9.1	-6.9	3.7	5.5	8.8

\*Since inception return: 3.6% (Sept. 2010)

### Outlook and positioning



In our view, we are in the last innings of the global economic expansion, and therefore growth is likely to remain positive in 2019, albeit at a much slower pace. Major economies have reached capacity limits and there is limited room for stimulus to propel further expansion. Tighter monetary policy, dwindling benefits from tax cuts and shrinking capacity for additional leverage will make it difficult for the economy to maintain its current growth rate. We believe this market environment of reduced earnings growth and rising macroeconomic risks could weigh on equities.

Looking at fixed income, we believe the U.S. Federal Reserve is signalling that the central bank could be closer to the end of its hiking cycle than previously anticipated. The high levels of debt accumulated since the credit crisis reduced the economy’s capacity to absorb higher interest rates and, in our view, markets are pricing in more interest rate hikes than are likely to occur in 2019. In credit, we believe default risk has yet to re-price in North America. The risk of corporate debt should not be underestimated; corporate loans outstanding have ballooned, the investment-grade universe is increasingly made up of BBB-rated offerings (one above junk), and short-term rates are rising. Refinancing risk, or the risk that companies will have to take on new debt at higher interest rates, is increasing and could negatively impact the least creditworthy issuers. The good news is that only a small portion of high-yield debts are coming due in 2019.

Given our view that we are in the late cycle, we are balancing the need for downside protection with the opportunity cost of not participating if equity markets continue to climb upward. The portfolios generally have a neutral weight to equity and we have deployed a put option spread strategy to add downside protection in an asymmetric fashion. In the equity component, we believe Canadian equities are becoming attractive as valuations are reasonable, volatility is lower and dividend yield is higher compared to markets such as the U.S. We are re-balancing our asset mix, trimming the winner, U.S. equity funds, and acquiring Canadian funds and ETFs. We expect to complete this by the end of January. Active management will be critical in the slowdown scenario as not all companies will be punished to the same degree; investors should favour companies with strong balance sheets and resilient

businesses. In the fixed-income portion, we prefer government bonds to credit. We do not see default to be an issue in 2019 as the need for principal repayment is low and interest service is manageable. However, the cost of financing is being re-priced upward and we may be better off lending in the future for higher rates. We are slowly selling our credit exposure for sovereign bonds and cash. In our view, the hiking cycle will finish earlier than expected, driving government bond returns higher and the U.S. dollar lower. We remain committed to hedging more than half of our U.S. dollar exposure.

We are concerned about refinancing risk. Debt levels are elevated across the developed world and if monetary conditions continue to tighten at the current pace, there is a real concern that the cost of financing for businesses will increase and vulnerable companies will go into default. The escalating global trade war also poses a risk to our outlook. Although both the U.S. and China have agreed to refrain from increasing tariffs for 90 days, it is unknown what can be accomplished in such a short timeframe. Europe and Japan are likely to move into U.S. crosshairs next. Overall, we believe the likelihood of a global recession in 2019 is low, but the odds are increasing. We believe that central banks are sensitive to the risk of hiking interest rates too much too quickly, however our put option strategy and government bond exposure help to offset that risk.

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