# Market Commentary
# Third Quarter 2018

CI Multi-Asset™ Management

**Portfolio Series and Portfolio Select Series**
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## Market performance

The S&P 500 Index, a measurement of the performance of the 500 largest U.S. companies, stood out with a 5.9% return for the quarter. Elsewhere in the world, Canada (as measured by the S&P/TSX Composite Index) lost 0.6%, Europe and Asia (MSCI EAFE Index C$) were 0.3% lower, and emerging markets (MSCI EM Index C$) shed 2.6%. Domestic bonds as represented by the FTSE Canada Universe Bond Index lost 1.0%. These five asset classes represent the main building blocks of most investors' portfolios. It was a challenging quarter to say the least, as only one of the five produced a positive result.

| Returns in % at September 30, 2018 | 3 mth | 1 yr | 3 yr | 5 yr | 10 yr |
|---|---|---|---|---|---|
| S&P/TSX Composite Index | -0.6 | 5.9 | 9.7 | 7.8 | 6.3 |
| S&P 500 Index C$ | 6.0 | 22.2 | 16.0 | 19.3 | 14.2 |
| MSCI World Index C$ | 3.5 | 15.9 | 12.9 | 15.1 | 11.4 |
| FTSE Canada Universe Bond Index | -1.0 | 1.7 | 1.6 | 3.3 | 4.4 |

Source: Bloomberg, FTSE

## Portfolio Series and Portfolio Select Series

Stock markets were incredibly "peaceful" in 2017 with very low volatility and very few down days. This year has been different. We had a global correction in February, weakness outside of the U.S. with, for example, emerging markets falling 18% from their peak in January. The strong performance was driven by very few names. During the third quarter, consumer technology (Apple), e-commerce (Amazon), and cloud services (Microsoft) led the growth. To put this concentration in perspective, Apple's contribution to the S&P 500 Index return was more than the combined contribution of *all* the companies from the following *seven* sectors: financials, consumer staples, energy, utilities, real estate, materials and telecommunications. In effect, investors were penalized for not owning Apple or not owning as much as 4.2%, which is Apple's average weight in the index.

During this quarter, we earned positive results in the balanced and equity-centric portfolios. Having exposure to U.S. stocks contributed to positive performance, while hedging some of the U.S. dollar exposure and favourable stock selection in Canadian and international markets added relative performance. Income portfolios recorded a modest loss but generally outperformed the fixed-income benchmark as diversification into stocks and lower-than-benchmark duration added value.

| Returns in % at September 30, 2018 (Class F) | 3 mo | 1 yr | 3 yr | 5 yr | 10 yr |
|---|---|---|---|---|---|
| Portfolio Series Income Fund | -0.3 | 1.8 | 3.5 | 5.2 | 6.4 |
| Portfolio Series Conservative Fund | -0.1 | 3.0 | 4.1 | 5.8 | 6.4 |
| Portfolio Series Conservative Balanced Fund | 0.6 | 3.7 | 5.0 | 6.6 | 6.8 |
| Portfolio Series Balanced Fund | 0.8 | 4.3 | 5.9 | 7.3 | 7.1 |
| Portfolio Series Balanced Growth Fund | 0.9 | 4.4 | 6.7 | 7.8 | 7.4 |
| Portfolio Series Growth Fund | 1.2 | 5.1 | 7.4 | 8.3 | 7.7 |
| Portfolio Series Maximum Growth Fund | 1.6 | 6.1 | 8.6 | 9.5 | 8.2 |
| Select Income Managed Corporate Class | -0.8 | -0.1 | 1.6 | 3.0 | n/a* |
| Select 80i20e Managed Portfolio | -0.4 | 1.0 | 3.0 | 4.2 | 5.3 |
| Select 70i30e Managed Portfolio | -0.2 | 1.5 | 3.4 | 4.6 | 4.0 |
| Select 60i40e Managed Portfolio | 0.0 | 2.1 | 4.0 | 5.1 | 6.0 |
| Select 50i50e Managed Portfolio | 0.2 | 2.6 | 4.6 | 5.6 | 6.4 |
| Select 40i60e Managed Portfolio | 0.5 | 3.3 | 5.3 | 6.3 | 6.7 |
| Select 30i70e Managed Portfolio | 0.8 | 3.8 | 5.9 | 6.8 | 7.1 |
| Select 20i80e Managed Portfolio | 1.2 | 4.5 | 6.9 | 7.6 | 7.5 |
| Select 100e Managed Portfolio | 1.7 | 5.8 | 8.3 | 8.8 | 8.2 |

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

**Select Income Managed Corporate Class**

Fixed income remained out of favour as investors feared that inflation could return in a meaningful way, driven by tight labour markets. The U.S. Federal Reserve continued to be ahead of other central banks and has already hiked three times this year. Rising rates and slowly unwinding quantitative easing seem to be having no adverse impact on the U.S. economy, likely because tax cuts have acted as an offset. However, rising rates and U.S. dollar appreciation have increased the debt burden of countries that have borrowed in U.S. dollars. Argentina, the poster child for reckless borrowing, failed to resolve its debt problem and was bailed out by the International Monetary Fund (IMF) on the condition that it cut government spending. Tight credit conditions, rising rates and spending cuts will most certainly put Argentina into recession.

There will likely be more economies to enter recession in the coming months as the world faces the consequences of rising U.S. rates and declining liquidity as the Fed unwinds its quantitative easing program, albeit slowly. The American economy is being supported by the new technology revolution and is likely to enter recession later. While its stock valuations may be high, the economy has solid momentum for now. This may motivate the Fed to continue to hike rates, creating more difficulties for companies that have weak balance sheets and countries that are overly indebted.

The 10-year U.S. Treasury yield has been retesting 3.15%. At this level, it is above inflation, hence generating positive real yield. It is also above the dividend yield of the S&P 500 companies, making Treasuries more attractive than in previous years. We suspect the yield is not far from a peak and the downside risk from this asset class is low as a 3.15% annual yield provides a large cushion to offset price movements. The Canadian 10-year bond will likely trade within a tight range and our base case is for the return to be in line with the yield. The base case assumes no recession, and no immediate rate cuts in the U.S. and Canada.

To enhance returns, we look for entry points to add stocks. At the end of the day, they have the largest return potential. We have room to add stocks in a meaningful way should we be motivated by improving valuations. To add stability until then, we own gold bullion and long bonds.

**Outlook and positioning**

Ten years ago, we were in the midst of a global financial crisis. Central banks reacted quickly with unprecedented tools: zero rates and quantitative easing. They bailed out asset holders but penalized asset builders, creating a social issue – a very wide wealth gap in almost every country, leading to low reported inflation and slow economic growth. Ten years ago, the Fed balance sheet was less than US$1 trillion; today it is $4.2 trillion. The Fed's effort to shrink its balance sheet has made very little progress – a decline of $0.3 trillion from the peak, which was three years ago. It is a long way from $1 trillion. As liquidity is being withdrawn, the economies of the U.S. and others are expected to slow. At this pace, it is unlikely that the Fed's quantitative easing will be fully unwound before the next recession.

There is a fair chance that the debt level of corporations, governments and individuals will remain high, increasing the risk of tight credit conditions and recession. Investors should invest diversely and avoid companies that have too much debt. Our portfolio management teams are focused on quality and value in selecting stocks – they are resisting the temptation to buy companies at high valuations. Such companies may have impressive short-term upside as everyone piles in but there have been many cases where this greed leads to wealth destruction over the longer term. Last year's darling, Bitcoin, fell 66% from its peak in less than a year.

Our portfolio asset mixes are generally neutral to the benchmark in terms of equity weight. This assures we participate in the upside. The equity portfolios have been optimized to favour countries that offer value and less downside. As investors seem to be focused on U.S. technology companies, Canadian equity has quietly become a compelling value investment, with high dividends, greater long-term return potential and lower volatility. We have continued to increase our allocation to Canadian equity. We are even more confident now that our country has reached the USMCA trade agreement with the U.S. and Mexico. It reduces uncertainty, allowing investors to focus on fundamentals.

This bull market that started in 2009 could run for longer. The odds for further gains appear high but the potential for a downturn is even greater based on the valuations. To manage the downside risk, we have designed and implemented a put option strategy. Think of it as low-cost insurance. Having all the bases covered reflects both the constructive and defensive views within our outlook.