FIRST ASSET
A CI Financial Company

FIRST ASSET LONG DURATION FIXED INCOME ETF
MANAGER COMMENTARY
Second Quarter 2017
TSX: FLB

Capital Appreciation

This is a summary of the First Asset Long Duration Fixed Income ETF's (the "Fund") performance in the second quarter, our outlook for the markets and the Fund's positioning.

Looking back – Reflation hopes fade, a shift toward coordinated tightening amid soft inflation

At the end of 2016, an investor poll conducted by J.P. Morgan showed that nearly 50% of those surveyed expected the benchmark U.S. 10-Year Bond Yield to be 2.5% or higher by the end of the second quarter of 2017, while some other broker-dealers forecasted 3% or higher for the U.S. 10-Year Bond Yield by mid-year. The reality has been very different with the 10-Year Bond Yield trading in a narrow range year-to-date and finishing the first half at 2.30%.
A proximate influence is the loss of investor confidence that "reflation" is in store, with such sentiments emerging as expectations surrounding the U.S. policy agenda have been tempered, commodity prices have slipped and current reported inflation readings to date have failed to pick up. A distinct lessening of tail risks from the political and banking spheres in Europe has provided little reassurance to investors.

The broadly supportive stream of economic activity data and weak coincident inflation readings over the first half of the year is garnering a mixed reception from two different audiences. Amid investor circles, it continues to be regarded with skepticism, given the current cycle experience of the follow-through from firming economic activity to higher inflation being tepid. Among policymakers at major inflation targeting central banks, however, the expectation persists that inflation will shift higher and move back toward their respective targets from currently subdued levels. The latter perception has led to some of these same central banks actively considering the reduction of their highly accommodative monetary policy stances, with the Bank of Canada, European Central Bank, and the Bank of England all jumping on this bandwagon of late. This collective desire to follow the Federal Reserve System's lead in gradually moving toward higher policy interest rates and smaller balance sheets supported the push higher in nominal yields from their year-to-date lows.
Over the second quarter, nominal 10-year interest rates (interest rate before taking inflation into account) dropped by 0.12% in the U.S. and rose 0.02% in Japan, while in Canada, Germany and the UK, these rates have risen by 0.13%.

Performance Analysis

The First Asset Long Duration Fixed Income ETF (the "Fund") returned 3.08% in the second quarter, falling behind the FTSE TMX Canada Long Term All Governments Index (the "Benchmark") return by 0.96%. The total return of the Fund was primarily driven by the net compression of government credit spreads and the net decline in long-term Canadian interest rates.
On a relative to the Benchmark basis, yield curve positioning subtracted from the performance of the Fund, as the Canadian term structure flattened sharply following a hawkish shift from the Bank of Canada, and our underweight position in 20-year maturity Canadian bonds hindered performance. This weakness was only partly offset by the outperformance of our U.S. duration positions relative to their Canadian counterparts, with residual U.S. dollar exposure also subtracting from the Fund's returns. The foreign currency exposure of the Fund is actively managed through a hedging overlay. In terms of spreads, our underweight government credit position affected returns negatively, as spreads in this sector tightened materially.

Looking forward – Risk of monetary policy missteps resurface

The most recent wave of central banks wanting to claim victory and walk back from highly accommodative monetary policy settings is concerning. Beyond that inflation has only tentatively followed suit from improved economic activity indicators, the reality is that financial conditions remain loose – in turn benefitting the economy – in part due to accommodating monetary policy. For policymakers, the rationale for starting the gradual withdrawal of monetary stimulus now is that the risk of a faster policy tightening later, that could derail the economy, is reduced. After years of such stimulus and the debt loads that have accumulated, however, there is a risk that economic sensitivities to changes in financial conditions are greater than appreciated by policymakers. It is only by beginning the process of policy tightening that both central bankers and financial markets will find out the truth, raising the risks of policy missteps along the way. The approach is either the right one: where higher inflation emerges, and term premiums in fixed income have room to normalize; or the wrong one: where tightening proves unwarranted in the face of stubbornly below target inflation, and policymakers eventually need to retrace their steps on policy normalization. Managing through the evolution of policy towards the ultimate outcome is a focus of our strategy for investing in today's challenging market environment.

The Canadian situation is an illustrative case in point for the current dilemma of many monetary policymakers. Although economic growth is broadening and the negative impact from lower oil prices has run its course, reported inflation and inflation expectations have not demonstrated commensurate improvements. For now, the Bank of Canada seems content that their response to the oil price collapse and resulting terms of trade shock has worked, paving the way for the withdrawal of this economic insurance via policy rate hikes. Should inflation remain below target and as tepid as both businesses and investors expect, however, the Bank will likely find that the limits of the path to higher policy rates are closer than envisioned.

Positioning – Duration, Curve, and Spreads

The Fund remains underweight in duration relative to the Benchmark, primarily concentrated in the 20-year portion of the yield curve. Provincial bonds are mainly used to manage this yield curve exposure, while collecting better income. Within the spread product space, we are underweight in agency and municipal debt, and we hold positions in U.S. dollar emerging market sovereign debt and inflation-linked bonds.
During the second quarter, we trimmed positions in 10-year and shorter maturity Canadian bonds, migrating this exposure to longer maturities, and also reduced our underweight position in Canadian government credit spreads. In addition, we have added positions in U.S. dollar emerging market sovereign debt, and reduced our exposure to U.S. inflation linked bonds.

	1 Month	3 Month	6 Month	YTD	1 Year	SI
First Asset Long Duration Fixed Income ETF	-1.28%	3.08%	4.48%	4.48%	-2.83%	1.13%
FTSE TMX Canada Long Term All Governments Index	-0.76%	4.04%	5.62%	5.62%	-1.01%	4.54%

Source: First Asset as at June 30, 2017 Inception date: May 11, 2016

[1]The indicated rates of return are the historical annual compounded total returns, including changes in unit value and do not take into account sales, redemption or optional charges or income taxes payable by a security holder that would have reduced returns. Use of benchmark:

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Signature Global Asset Management

Signature Global Asset Management manages a diverse range of equity, balanced and income funds, and is CI Investments' largest in-house portfolio management group. The team of over 40 investment professionals, led by Chief Investment Officer Eric Bushell, manages over $55 billion and has offices in Toronto and Hong Kong.

Investment Philosophy

The Signature investment philosophy is designed to deliver the best possible risk-adjusted returns in today's complex environment and is based on these key elements:

- The globalization of the world economy has resulted in increased complexity, requiring specialized knowledge.

- The increased interconnectivity of the global economy demands collaboration.

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First Asset - **Smart Solutions™**

First Asset, a CI Financial Company, is a Canadian investment firm delivering a comprehensive suite of smart ETF solutions. Rooted in strong fundamentals, First Asset's smart solutions strive to deliver better risk-adjusted returns than the broad market while helping investors achieve their personal financial goals.