# FIRST ASSET LONG DURATION FIXED INCOME ETF
MANAGER COMMENTARY
December 31, 2018
**TSX: FLB**



## Results of Operations

### Market Overview

- The fourth quarter of 2018 featured continued tightening of global financial conditions, and despite the U.S. Federal Reserve (Fed) delivering a dovish hike in December, markets experienced heightened volatility. Almost every major asset class ended the year with negative returns, while global government bonds outperformed, and U.S. three-month T-bills returned 1.8%.
- In developed markets, the U.S. continued to grow at a moderate pace and payroll growth remained robust even though the Fed raised rates by 100 basis points through the year. On the back of this monetary policy tightening, the dollar continued to strengthen against most G10 currencies in the fourth quarter, while the 10-year U.S. Treasury yield collapsed from a high of 3.23% in early October to 2.68% by the end of the year. The recent flattening of the U.S. Treasury yield curve is indicative of market worries about a policy misstep by the Fed.
- In Canada, the Bank of Canada (BoC) hiked its policy rate in October, the third time this year, to 1.75%. Since then, the collapse in energy prices has resulted in downward revisions to the growth and inflation outlook over the year ahead. Against this backdrop, the Canadian 10-year yield dropped by 46 basis points to 1.96% at year-end, while Canadian dollar almost declined by 6% against the U.S. dollar through the quarter.
- In Europe, recent economic data has worsened as Purchasing Managers' Indexes (PMIs) slumped further, particularly in France as the "gilets jaunes" protests have slowed down activity. Germany too has seen pronounced decline and, in line with other developed markets, the German 10-year yield also declined during the fourth quarter to end 2018 at 0.24%. From a political standpoint, Italy reached an agreement with the European Commission on its budget plan and this helped Italian government spreads outperform other peripheral spreads in Europe.

### Performance summary and factors affecting fund performance

- The First Asset Long Duration Fixed Income ETF (the "Fund") advanced by 2.68% in the fourth quarter, outperforming the FTSE Canada Long Term Government Bond Index (the portfolio benchmark) by 0.34%.
- The total return outcome of the portfolio was primarily driven by a significant drop in Canadian interest rates, with some offset coming from a widening of Canadian government credit spreads.
- On a relative to Benchmark basis, government credit exposure and Canadian duration positioning were the most significant contributors to the Fund's performance.
- Duration and yield curve positioning added to portfolio alpha, stemming from our overweight duration position in 7-year to 10-year maturity Canadian bonds relative to longer maturities, and a decreasing underweight overall duration position, as interest rates fell and the yield curve steepened during the reporting period. The Government of Canada 10-year bond yield fell by some 46 basis points (bp) over the quarter, while the 10-year to 30-year segment of the yield curve steepened by 22bp in the same timeframe. Underweight government credit exposure was also alpha accretive, as spreads in this sector widened 16-20bp across the curve during the reporting period.

### Portfolio activity and positioning

- Portfolio duration is about in line with the Benchmark, featuring an overweight in the 7-year to 10-year area and an underweight in the 20-year portion of the yield curve.
- In the spread product domain, we are underweight Canadian government agency debt.
- In the fourth quarter, we added to duration gradually in the 10-year and 30-year areas of the yield curve amid the shift lower in longer-term interest rates. Additionally, our underweight government credit position was held amid concerns that budgetary deficits and borrowing requirements of various levels of Canadian governments would rise in an environment of softer economic activity, leading to wider credit spreads in this sector.

## Market Outlook

- Economic indicators in the U.S. seem mixed – While consumer sentiment and labour markets continue to be healthy, business activity is showing signs of slowing down. Given the recent communication from the Fed, it seems unlikely they can deliver more than one hike in 2019, and this should allow the U.S. economy to continue growing at a moderate pace, even as fiscal stimulus fades.
- The sharp repricing of rates across developed markets over the past few months has created opportunities for risky assets, leaving some room for credit spreads to narrow in the near term. As markets discount the end of Fed rate hikes alongside a slowing, but still growing above potential U.S. economy, the risk of weakness in the U.S. dollar begins to surface, which would in turn ease global and emerging markets financial conditions in 2019.
- Prospects for additional rate hikes by the BoC have eroded, with markets pricing in less than one 25bp increase over the next 12 months. The collapse in energy prices, tightening financial conditions and trade tensions between the U.S. and China are seen slowing the Canadian economy and dragging inflation below the 2% target of the BoC.
- On energy concerns, in particular, the discount for Canadian crude relative to global oil prices has eased of late courtesy of imposed production cuts, but additional pipeline capacity is required for this development to be sustained. Meanwhile, global oil prices remain at depressed levels that are unlikely to prompt a pick-up in energy sector capital expenditures.
- We believe that the European Central Bank may have missed its chance for policy normalization. Having ended quantitative easing in December, its next move in 2019 might be a loosening of policy through an extended targeted longer-term refinancing operations program that provides inexpensive funding for banks to lend to the real economy in hopes that this lending will be used to boost growth.
- In the U.K., the focus continues to be Brexit negotiations, with the March 29 deadline fast approaching and inadequate support in Parliament for the negotiated agreement.

## Fund Performance

| | 1 Month | 3 Month | 6 Month | YTD | 1 Year | 2 Year | SI |
|---|---|---|---|---|---|---|---|
| First Asset Long Duration Fixed Income ETF | 2.15% | 2.68% | 0.04% | -0.46% | -0.46% | 2.21% | 0.48% |
| FTSE Canada Long Term Government Bond Index CAD | 1.96% | 2.34% | -0.33% | 0.50% | 0.50% | 3.46% | 2.21% |
| FTSE Canada Universe Bond Index CAD | 1.36% | 1.76% | 0.79% | 1.41% | 1.41% | 1.96% | 1.61% |

Source: First Asset as at December 31, 2018

Inception date: May 11, 2016

Use of benchmark: FTSE Canada Long Term Government Bond Index is designed to track the performance of the long term (over 10 years) government of Canada bonds denominated in Canadian Dollars (CAD). The index is used as a benchmark to help you understand the Fund`s performance relative to the performance of long-term government fixed income marketplace.

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.

SIGNATURE
GLOBAL ASSET MANAGEMENT™

**John Shaw, CFA**
Vice-President, Portfolio Management and Portfolio Manager
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 $50 billion as of December 31, 2018 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.



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.



1902-0457_E (02/19)