Credit Absolute Return Strategy

As of June 30, 2018

Strategy description

The Credit Absolute Return strategy invests in diversified long and short positions of North American credit securities with an objective to generate positive returns throughout a complete credit cycle. Credit selection serves as the key pillar of strategy, supported by independent fundamental credit analysis. The investment team maintains a diversified and liquid portfolio with reduced interest rate risk exposure and an average credit rating of investment grade. The primary drivers of performance throughout the credit cycle include:

- Leveraged investment grade credit
- Long/short credits
- Arbitrage opportunities

Why invest?

- An alternative to a traditional fixed income portfolio with strong diversification benefits.
- Credit-driven returns with reduced sensitivity to interest rate risk.
- Ability to generate positive returns throughout a complete credit cycle.

Portfolio characteristics

Bond rating (%)	Long	Short	Net
AAA	63.9	-137.5	-73.6
AA	62.0	0.0	62.0
A	52.1	-12.8	39.4
BBB	66.4	-12.3	54.1
BB	22.0	-5.0	17.0
B	0.0	0.0	0.0
Not rated	1.1	0.0	1.1
Total	**267.6**	**-167.6**	**100.0**

Portfolio exposure (%)	Long	Short	Net
Investment grade	150.1	-22.5	127.5
High yield	20.0	-4.9	15.1
Bank loans	4.4	0.0	4.4
Cash, short-term investments and other net assets	88.2	0.0	88.2
Government bonds	1.0	-137.5	-136.5
Preferred stocks — CDN	2.5	-2.6	-0.1
preferred stocks — USD	1.4	0.0	1.4
Options	0.0	0.0	0.0
Total	**267.6**	**-167.6**	**100.0**

Characteristic	
Duration	0.43
Weighted Average Credit Weighting	A+
Gross Leverage	1.5 X

Highlights

Inception	December 31, 2013
Strategy AUM	$228 MM
Liquidity	Daily
Holdings	193
Currency	100% hedged
Incentive fee	Yes
High water mark	Annual
Hurdle rate	5%

Performance

Compound returns (%)

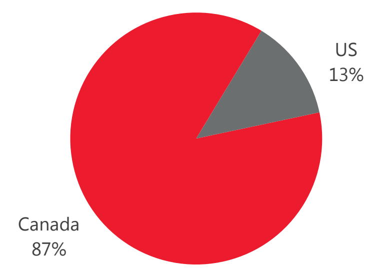
1 mth	3 mth	6 mth	1 yr	2 yr	3 yr	Inception
0.00	0.20	0.49	2.71	6.67	7.83	8.59

Calendar year returns (%)

YTD 2018	2017	2016	2015	2014
0.49	7.88	6.60	12.57	11.36

Top corporate issuers (%)	
Canadian Oil Sands	11.4
TD	9.8
Choice Properties	9.1
CIBC	8.4
Bank of Nova Scotia	7.8
Enbridge	6.4
Toyota	6.0
Wells Fargo	5.9
OMERS Realty Corp	5.5
Ford Credit Canada	5.3
Total	**75.7**

Geographic allocation



Comparative analysis (since inception)

	Credit Absolute Return Strategy	FTSE TMX Canadian Universe Bond Index	Barclays High Yield VLI C$ Hedged	S&P / TSX Composite Index
Annualized Return	8.59%	3.76%	3.99%	7.16%
Standard deviation	4.23%	4.02%	5.74%	7.49%
Sharpe ratio	1.73	0.62	0.48	0.79
% of positive months	83%	63%	65%	65%
Max drawdown	-4.45%	-3.55%	-10.64%	-13.77%
Yield to Maturity C$	3.60%	2.67%	6.69%	NA
Avg Modified Duration	0.43	7.57	3.99	NA
Avg. Credit Rating	A+	AA	B1/B2	NA
Correlation to Fund		0.07	0.14	0.11

Source: Bloomberg, FTSE TMX Global Debt Capital Markets

Scotia Institutional Asset Management™

Performance returns for the Credit Absolute Return Composite ("Strategy") are included to demonstrate how an investment fund with a similar investment strategy performed over the time period indicated. Periods of more than one year are annualized. Portfolio characteristics are of the Scotia Institutional Credit Absolute Return Fund. There is no guarantee that the Strategy would have invested in the same holdings as the Fund, and actual performance would have be different due to differences in underlying holdings and inception periods. The indicated rates of return are reported net of trading expenses but before the deduction of management fees. Past performance is no indicator of future performance.

Portfolio commentary (as of June 30, 2018)

Marc-André Gaudreau, CPA, CGA, CFA, Vice President & Portfolio Manager, Fixed Income

The Credit Absolute Return Strategy was flat in June as North American credit markets remained relatively quiet and the contributions from all three strategies were fairly subdued. Since the tights of January, Canadian investment grade corporate spreads have slowly ratcheted wider as a function of: 1) higher rates resulting in less in demand, 2) an active M&A market in the U.S. leading to greater supply, and 3) several "risk-off" moves forcing investors to the sidelines. We note that each "risk-off" move experienced this year pushed corporate spreads wider, however, spreads generally failed to mean-revert. It should be noted that the strategy's current utilization of leverage in the leveraged investment grade strategy remains low at slightly over 1x. We have taken advantage of the recent spread widening to recycle T-Bill maturities into 2018 single A or better corporate bonds. In our top 10 holdings, six now have a 2018 maturity. We believe this is a prudent way to invest capital and earn income in a mild credit spread widening environment. We intend to sell them and to recycle it into 5-year investment grade corporate bonds when the environment becomes more appropriate for credit spreads.

Aside from the weakness in investment grade corporate spreads, we finally received some good news from Enbridge. The positive Line 3 replacement outcome (approved June 28th) and monetization of natural gas gathering and processing assets moves Enbridge closer to its strategic priority of becoming a pure-play regulated pipeline and utility business. After a tough start to the year where execution uncertainty forced a re-pricing of the company's capital structure, investors in Enbridge securities are finally seeing some relief. Since the recent Line 3 and asset sale announcement, Enbridge's C$ hybrid bonds are tighter by ~15 bps. The strategy continues to be long Enbridge preferred shares and C$ hybrid securities as part of its long/short credit strategy.

On a broader level, does the Enbridge Line 3 replacement project and recent Canadian government intervention on the TMX pipeline begin to attract investors back to Canadian energy-related securities? We think it is a bit early to answer this question but it is worth watching the sector to see if the current negative sentiment associated with the Canadian energy sector starts to lift. During the month we initiated a CAD/USD arbitrage position in a hybrid bond security, while we also participated in selective investment grade and BB-rated high yield new issues where new issue concessions were priced attractively.

About Scotia Institutional

Scotia Institutional Asset Management provides progressive and innovative investment solutions to meet the challenges facing institutional clients, including pension funds, non-profits, foundations and corporations.

$128 Billion assets under management*

Fixed Income

The Scotia Institutional Asset Management fixed income team offers a diverse set of fixed income capabilities and solutions, ranging from traditional benchmark-driven to absolute return strategies. We seek to deliver alpha over a full market cycle through the application of a capital preservation philosophy and distinctive investment processes designed to optimize the trade-off between reward and risk.

To complement the skills of our fixed income team, proprietary systems help identify, quantify and manage risks associated with the market. This combination of skills and technologies enables a proactive approach to protecting and growing our clients' capital.

For more information, please contact:

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* As at June 30, 2018. AUM is for 1832 Asset Management L.P., a limited partnership the general partner of which is wholly owned, directly and indirectly, by The Bank of Nova Scotia and is a manager of mutual funds and investment solutions for private clients, institutional clients and managed asset programs.