

Canadian Investment Grade Corporate Bond Strategy

As of September 30, 2018

Strategy description

Scotia Institutional Canadian Investment Grade Corporate Bond strategy seeks to achieve total return under a capital preservation philosophy through an actively managed and diversified portfolio of primarily investment grade Canadian corporate bonds.

The investment team maintains a well-diversified and liquid portfolio that invests in companies with the greatest potential of delivering strong risk adjusted returns. The team will seek to identify organizations that show improving fundamentals based upon independent credit analysis, while managing with a capital preservation philosophy.

Why invest?

- Active management can produce superior risk adjusted returns for fixed income investors.
- Value added through security selection, driven by independent fundamental credit analysis.
- Strategy is flexible and responsive to credit market conditions, prioritizing diversified and liquid security selection.

Portfolio characteristics

Asset allocation (%)

Cash & Equivalents	0.5
Government/Provincial Bonds	5.9
Investment Grade Corporate Bonds	90.4
High Yield Bonds	3.1
Total	100.0

	Canadian IG Corporate Bond Strategy	FTSE Canada All Corporate Bond Index
Yield to Maturity	3.51%	3.44%
Coupon	3.45%	3.71%
Duration	6.04	6.13
Average Spread (bps)	119	113
Average Credit Rating	A	A
Number of Issues	63	194

Bond rating (%)	Canadian IG Corporate Bond Strategy	FTSE Canada All Corporate Bond Index
AAA	7.8	2.3
AA	28.9	24.6
A	25.5	35.6
BBB	34.7	37.5
<BBB	3.1	0.0
Total	100.0	100.0

Highlights

Inception	March 1, 2013
Strategy AUM	\$479 MM
Liquidity	Pooled: Daily
Holdings	155
Currency	Hedged
Benchmark	FTSE Canada All Corporate Bond Index

Performance

Compound returns (%)	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	Incept.
Composite	-0.71	-0.28	0.04	2.02	3.09	4.10	3.55
Benchmark	-0.79	-0.46	-0.04	2.10	2.65	3.69	3.12
Value add	0.08	0.18	0.08	-0.08	0.44	0.42	0.43

Calendar returns (%)	YTD 2018	2017	2016	2015	2014
Composite	0.24	3.67	4.89	2.76	8.04
Benchmark	0.23	3.38	3.73	2.71	7.59
Value add	0.01	0.29	1.16	0.05	0.45

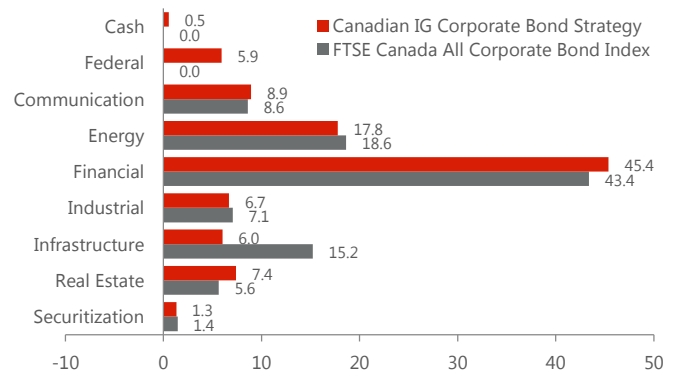
Top 10 issuers (%)

TD	7.7
Bank of Nova Scotia	6.8
CIBC	6.7
Royal Bank	6.2
Bank of Montreal	5.1
BCE	3.5
Telus Corp	3.2
Enbridge	2.8
Altagas	2.6
Veresen	2.3
Total	46.8

Top 10 holdings (%)

Bank Of Nova Scotia 2.98% 17-apr-23	4.0
Canadian Imperial Bank 1.9% 26-apr-21	2.7
Royal Bank Of Canada 2.35% 09-dec-19	2.7
Canadian Imperial Bank 2.04% 21-mar-22	2.4
Bank Of Montreal 3.4% 23-apr-21	2.1
TD Bank 3.005% 30-may-23	2.0
Enbridge Inc 5.375 27-sept-2077/2027	1.9
Toronto-dominion Bank 1.909% 18-jul-23	1.9
Altagas Ltd 4.12% 07-apr-26	1.5
Wells Fargo & Company 2.509% 27-oct-23	1.4
Total	22.6

Industry allocation (%)



Sources: Bloomberg, FTSE Global Debt Capital Markets



Quarterly commentary

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



The third quarter of 2018 marked the 10-year anniversary of the bankruptcy of Lehman Brothers, which catalyzed the onset of the most significant financial crisis since the Great Depression. The equity market rally at the end of the crisis is still going strong and made history by becoming the longest bull market ever. Fixed income investors generally experienced losses in the third quarter as interest rates in most areas of the globe increased. Interest rates increased in both Canada and the United States, with the front end of the yield curve rising slightly more than the back end. Investment grade credit spreads finished the quarter close to where they started, but did spike slightly higher at the beginning of the quarter. Canadian credit spreads have risen over the course of 2018 by approximately 5 bps.

The strategy was positioned with a slightly shorter duration view compared to the benchmark during the quarter. Although the curve and duration components of return generated an absolute negative return, from a relative return perspective they were both positive contributors. Credit selection was the main contributor to relative performance. From a sector allocation perspective, the underweight positions in the infrastructure and industrial sectors contributed while the overweight positions in the federal government securities, and financial and real estate sectors detracted relative performance. Overall the strategy outperformed its benchmark for the quarter.

We expect U.S./China trade war rhetoric to pick up and as November 6th draws closer investors will increasingly focus on midterm elections in the U.S. Interest rates will remain topical as strong U.S. economic data coupled with higher energy prices could result in another hike by the Fed before year end. We expect the Bank of Canada will be forced to keep up with the Fed and Stephen Poloz will face increased pressure to raise rates now that uncertainty surrounding NAFTA is out of the way. We continue to believe that the potential for market turbulence remains high as a result of these factors noted above coupled with Central Bank balance sheet normalization activities and the fact that many asset classes remain overvalued.

We continue to remain positioned relatively defensively and weighted towards higher-quality issuers. We have noted previously that there are many high-quality issues trading at discounts well below par that we find attractive. These below-par securities offer higher convexity towards various take-out scenarios, better capital protection in the event of any credit stress, and a more favourable tax-adjusted overall return since a portion of the yield is the form of a capital gain rather than income.

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.

\$127 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 September 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.

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