Credit Absolute Return Strategy

As of March 31, 2019

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	48.6	-110.3	-61.7
AA	63.2	-1.2	62.0
A	45.7	-14.3	31.4
BBB	78.2	-16.3	61.9
BB	15.5	-6.1	9.4
B	0.0	-4.0	-4.0
Not rated	1.0	0.0	1.0
Total	**252.1**	**-152.1**	**100.0**

Portfolio exposure (%)	Long	Short	Net
Investment grade	138.7	-26.7	112.0
High yield	14.0	-9.6	4.4
Bank loans	4.1	0.0	4.1
Cash, short-term investments and other net assets	90.5	0.0	90.5
Government bonds	1.1	-110.3	-109.2
Preferred stocks — CDN	2.7	-5.6	-2.9
preferred stocks — USD	1.0	0.0	1.0
Options	0.0	0.0	0.0
Total	**252.1**	**-152.1**	**100.0**

Characteristic	
Duration	0.16
Weighted Average Credit Weighting	AA-
Gross Leverage	1.2 X

Highlights

Inception	December 31, 2013
Liquidity	Daily
Holdings	192
Currency	100% hedged
Incentive fee	Yes
High water mark	Annual
Hurdle rate	5%

Performance

Compound returns (%)

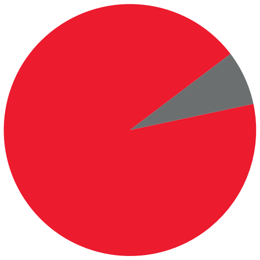
1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	Inception
0.30	1.94	0.62	1.71	6.53	7.06	7.62

Calendar year returns (%)

2019	2018	2017	2016	2015	2014
1.94	0.08	7.88	6.60	12.57	11.36

Top corporate issuers (%)	
Enbridge	12.0
Canadian Oil Sands	11.7
Wells Fargo	10.6
Ford Credit Canada	6.5
Dollarama Inc.	5.9
OMERS Realty Corp	5.6
Choice Properties	5.5
Pembina Pipeline	5.5
Brookfield Property	5.4
CIBC	5.3
Total	**74.1**

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	7.62%	4.13%	4.32%	6.36%
Standard deviation	4.01%	3.86%	5.75%	8.88%
Sharpe ratio	1.48	0.64	0.46	0.53
% of positive months	81%	63%	65%	63%
Max drawdown	-4.45%	-3.55%	-10.64%	-13.77%
Yield to Maturity C$	3.67%	2.32%	6.55%	NA
Avg Modified Duration	0.16	7.71	3.51	NA
Avg. Credit Rating	A+	AA	B1/B2	NA
Correlation to Fund		0.05	0.18	0.16

Source: Bloomberg, FTSE TMX Global Debt Capital Markets

Scotia Institutional Asset Management™

Quarterly commentary (as of March 31, 2019)

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

The Credit Absolute Return strategy rose 1.94% in the first quarter of 2019 as the year opened with a strong rebound in risk assets following the selloff that occurred during the last month of 2018. The strategy was led higher by the leveraged investment grade corporate bond strategy, which benefited from the overall tightening in credit spreads. The long/short positioning was also a positive contributor towards performance, while the credit arbitrage positioning was a small detractor.

Investors increasingly chased returns in "safe havens" vs. placing large bets in higher-beta areas during Q1. As a result, demand for BB bonds pushed spreads vs. BBB bonds almost back to their September tights of 63 bps. The rally in BB's was not felt as much in single B's and CCC's, signaling that high yield investors are not fully convinced that the market has turned a corner from the December lows. The move was further exasperated by a general lack of high yield new issues, forcing investors into the secondary market to deploy cash. As a result of this strong technical bid, we initiated several short positions in expensive BB's that have little hope of reaching investment grade status anytime soon and we monetized gains in several high yield longs while rotating capital into higher quality investment grade issuers. If the rally persists, we will look to add to this short position as we view the current spread between BB and BBB bonds to be too tight and unsustainable.

Positions in TransAlta's discounted rate reset preferred shares and senior unsecured notes benefitted as Brookfield Renewable Partners agreed to invest $750 million in the company through certain exchangeable securities and Management intends to use the proceeds to retire debt, fund capital expenditures and buyback shares over the next 3 years. TransAlta, a power producer in Alberta, has been slowly deleveraging its balance sheet in recent years having being downgraded by rating agencies in 2015. The company owns key power producing assets in the province including some highly valuable and low-cost hydro generation assets that are expected to deliver higher free cash flow in the coming years as below-market power purchase agreements roll off. In our view, TransAlta is a perfect example of a "fallen angel". We believe that TransAlta's securities are currently priced at attractive levels and Brookfield's recent investment is positive for the credit as it helps to reinforce the valuation of the company's assets.

Our overall positioning remains generally conservative as we continue to employ a modest amount of leverage in the levered investment grade strategy, and will look to add leverage (much like we did in late 2018 / early 2019) if valuations support an improved risk/reward relationship. The credit market has shown very strong performance since the beginning of the year and we see no reason to chase returns here unless the risk/reward is skewed in our favour. We continue to be comfortable with our existing short themes as 2019 progresses and maintain a bearish view towards credits that are exposed to over-leveraged Canadian consumers.

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 December 31, 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.