Credit Absolute Return Strategy

As of December 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	50.5	-109.2	-58.7
AA	35.8	0.0	35.8
A	52.6	-11.7	40.9
BBB	82.6	-11.9	70.7
BB	19.9	-9.1	10.8
B	0.0	0.0	0.0
Not rated	0.5	0.0	0.5
Total	**241.9**	**-141.9**	**100.0**

Portfolio exposure (%)	Long	Short	Net
Investment grade	148.9	-22.2	126.7
High yield	19.9	-7.8	12.0
Bank loans	0.7	0.0	0.7
Cash, short-term investments and other net assets	66.8	0.0	66.8
Government bonds	1.1	-109.2	-108.1
Preferred stocks — CDN	4.6	-2.7	1.9
preferred stocks — USD	0.0	0.0	0.0
Options	0.0	0.0	0.0
Total	**241.9**	**-141.9**	**100.0**

Characteristic	
Duration	0.83
Weighted Average Credit Weighting	A+
Gross Leverage	1.4 X
Yield to Maturity	3.58%

Highlights

Inception	December 31, 2013
Liquidity	Daily
Holdings	153
Currency	100% hedged
Incentive fee	Yes
High water mark	Annual
Hurdle rate	5%

Performance

Compound returns (%)

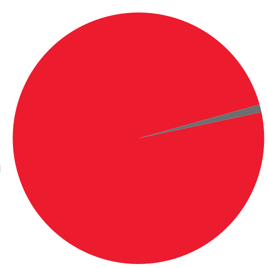
1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	Inception
0.76	1.26	1.56	4.87	4.23	6.32	7.15

Calendar year returns (%)

2019	2018	2017	2016	2015	2014
4.87	0.08	7.88	6.60	12.57	11.36

Top corporate issuers (%)	
Suncor Energy	13.7
Royal Bank of Canada	9.6
Gibson Energy	9.6
Enbridge Pipelines	8.8
Pembina Pipeline	8.4
Bank of Montreal	8.3
Dollarama Inc.	6.1
Choice Properties	5.5
OMERS Realty Corp	5.5
TransAlta Corp	5.2
Total	**80.6**

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	7.15%	4.09%	4.78%	6.98%
Standard deviation	3.78%	3.81%	5.55%	8.66%
Sharpe ratio	1.45	0.64	0.56	0.61
% of positive months	81%	63%	68%	65%
Max drawdown	-4.45%	-3.55%	-10.64%	-13.77%
Yield to Maturity C$	3.58%	2.28%	5.85%	NA
Avg Modified Duration	0.83	7.99	3.03	NA
Avg. Credit Rating	A+	AA	B1/B2	NA
Correlation to Fund		0.03	0.17	0.15

Source: Bloomberg, FTSE TMX Global Debt Capital Markets

Scotia Institutional Asset Management™

Quarterly commentary (as of December 31, 2019)

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

Risk asset valuations marched higher during the 4th quarter and the Credit Absolute Return strategy benefitted, returning 1.26%. President Trump dialed down his trade war rhetoric in time for the holidays and it seemed increasingly likely that a "Phase 1" trade agreement would be reached between the US and China. Investors quickly added risk to portfolios in anticipation of a Santa Claus rally to close out the year as concerns regarding global growth fell quiet. Credit spreads rallied during the quarter to close at the tightest levels of the year.

Looking forward to 2020, the US election will dominate headlines and we expect President Trump to continue to focus on policies/rhetoric that is supportive to risk asset valuations. His path towards re-election will likely be charted by the performance of US equities, and for that reason, we do not expect him to rock the boat. That being said, at current valuations it could be argued that his re-election is fully priced in and if the odds of Democrats taking control start to increase, it could be a headwind for risk assets as the year progresses.

In Canada, with the election now firmly behind us, we believe the health of the Canadian consumer and pockets of economic weakness will remain topical with investors. Canadians remain over-levered and consumer credit metrics have been steadily deteriorating. As a reminder, the strategy remains short the expensive subordinated securities of less diversified Canadian financials, which we believe are exposed to consumer weakness.

If there was one asset class that did not participate in the 2019 rally, it was Canadian preferred shares. As the year progressed, Canadian investors dumped their preferred shares at indiscriminate levels with many investors exiting the asset class altogether. As Central Banks became more dovish, investors increasingly feared the impact of rate-reset structures that dominate the Canadian market. The fact that credit valuations, which approached all-time tights this year, are also a component of preferred share valuations was largely ignored by investors. The large outflows left the market severely dislocated and as an example, there are many high yield credits with yields that are materially lower than the preferred shares of higher quality Canadian issuers. To take advantage of this weakness, the strategy recently made an allocation to Canadian preferred shares as part of its long/short strategy. Another potential bright spot for 2020 in credit remains the energy sector, where investors remain underweight and valuations are cheap. Our strategy's energy investments are focused on higher quality issuers with stable and predictable cash flows such as strategic pipelines and other midstream assets.

We continue to employ a modest amount of leverage in the levered IG strategy, and will look to add leverage if valuations support an improved risk/reward relationship. We continue to see no reason to chase returns at current valuation levels and prefer to add exposure when the risk/reward relationship is more skewed in the strategy's favour.

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.

$142 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, 2019 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.