Canadian Investment Grade Corporate Bond Strategy

As of December 31, 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	0.3
Government/Provincial Bonds	11.9
Investment Grade Corporate Bonds	84.1
High Yield Bonds	3.7
Total	**100.0**

	Canadian IG Corporate Bond Strategy	FTSE Canada All Corporate Bond Index
Yield to Maturity	3.45%	3.44%
Coupon	3.41%	3.32%
Duration	6.00	6.14
Average Spread (bps)	153	148
Average Credit Rating	A	A
Number of Issues	64	197

Bond rating (%)	Canadian IG Corporate Bond Strategy	FTSE Canada All Corporate Bond Index
AAA	13.7	2.4
AA	24.2	24.4
A	23.6	35.0
BBB	34.8	38.2
<BBB	3.6	0.0
Total	**100.0**	**100.0**

Highlights

Inception	March 1, 2013
Strategy AUM	$452 MM
Liquidity	Pooled: Daily
Holdings	151
Currency	Hedged
Benchmark	FTSE Canada All Corporate Bond Index

Performance

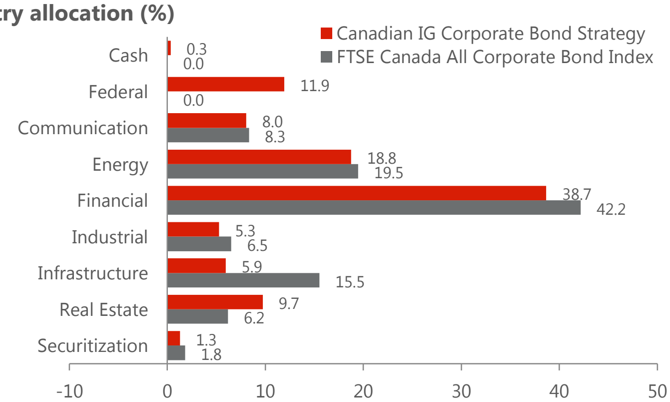
Compound returns (%)	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	Incept.
Composite	1.04	0.59	0.30	0.83	3.12	4.01	3.50
Benchmark	1.06	0.86	0.40	1.10	2.73	3.68	3.13
Value add	**-0.02**	**-0.28**	**-0.10**	**-0.27**	**0.39**	**0.33**	**0.36**

Calendar returns (%)	2018	2017	2016	2015	2014
Composite	0.83	3.67	4.89	2.76	8.04
Benchmark	1.10	3.38	3.73	2.71	7.59
Value add	**-0.27**	**0.29**	**1.16**	**0.05**	**0.45**

Top 10 issuers (%)	
Bank of Nova Scotia	6.7
TD	6.5
CIBC	5.7
Bank of Montreal	5.1
BCE	3.2
Royal Bank	2.6
Telus Corp	2.6
Altagas	2.5
Enbridge	2.3
Brookfield Asset Mgt	2.2
Total	**39.4**

Top 10 holdings (%)	
Bank Of Nova Scotia 2.98% 17-apr-23	4.0
Canadian Imperial Bank 1.9% 26-apr-21	2.7
Bank Of Montreal 3.4% 23-apr-21	2.1
Canadian Imperial Bank 2.04% 21-mar-22	2.0
TD Bank 3.005% 30-may-23	1.9
Toronto-dominion Bank 1.909% 18-jul-23	1.9
Altagas Ltd 4.12% 07-apr-26	1.4
Wells Fargo & Company 2.509% 27-oct-23	1.4
Royal Bank Of Canada 2.86% 04-mar-21	1.4
Aimco Realty Investors L 2.266% 26-jun-24	1.3
Total	**20.2**

Industry allocation (%)



Sources: Bloomberg, FTSE Global Debt Capital Markets

Scotia Institutional Asset Management™

Quarterly commentary

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

Heading into the final quarter of 2018, Canadian fixed income investors were on track to lose money, but increased market volatility and an equities sell-off drove investors back into the fixed income market to generate positive returns for the year. Both the Bank of Canada and the US Federal Reserve lifted short term policy rates as both central banks are looking to normalize interest rates. Corporate bond spreads widened significantly, ending the quarter at the widest level since mid-2016. The FTSE/TMX Corporate bond index returned 0.86% in the quarter, underperforming the broad Canadian fixed income index by 90 bps.

The Canadian Investment Grade Corporate Bond strategy benefited from the risk-off tone during the quarter and rose 0.59%, though underperformed the benchmark slightly due to select energy issuers and an underweight position in infrastructure and financials. The curve and duration components of return generated absolute positive returns for the strategy, and were positive contributors relative to the benchmark. Additionally, the overweight position in Federal government bonds contributed positively towards performance.

In our view, the dominant theme facing investors in 2019 will be the pace of the Federal Reserve's current hiking cycle and its balance sheet normalization activities. The big question facing investors as we start 2019 is will the current market sell-off cause the Fed to blink, or will they remain steadfast and data dependent in their efforts to tighten financial conditions? Further, the lack of liquidity coupled with the growing influence of passive investing vehicles such as index ETFs has created an environment where increased volatility is the "new normal". In the absence of a pause in the Fed's program to tighten financial conditions, we expect this environment to persist through 2019.

Our positioning remains defensive with credit selection skewed towards higher quality issuers with strong cash flows and stable balance sheets. 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. In light of current attractive valuations, we have recently added exposure in several of our favorite credits where the risk/reward trade-off has improved considerably. We continue to have a slightly shorter duration relative to the benchmark to mitigate the impact of a rising rate environment.

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.