

# Tactical Bond Strategy

As of December 31, 2018

## Strategy description

Scotia Institutional Tactical Bond Fund invests with an objective to maximize total return by optimizing the risk/reward trade-off in changing market environments.

The Tactical Bond strategy's alpha is derived from core levers such as duration and yield curve positioning, sector allocation and security selection, but also complemented with non-core holdings such as foreign investments and modest currency exposure in order to enhance yield and maximize return in a risk-controlled framework.

The Tactical Bond strategy also integrates the notion of active and tactical management to a higher degree compared to more traditional bond solutions.

## Why invest?

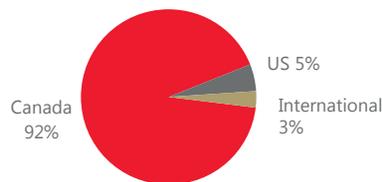
- Active management can produce superior risk adjusted returns for fixed income investors.
- Value added through foreign exposure, discrete currency hedging and tactical positioning.
- Multiple strategies are used to diversify risk.
- Strategies are flexible and responsive to market conditions.

## Portfolio characteristics

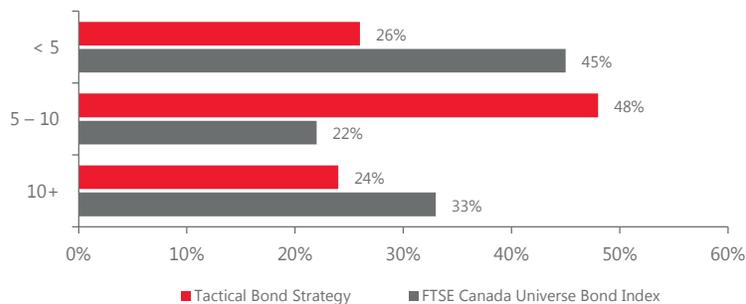
### Top 5 issuers (%)

Government of Canada	34.9
Province of Ontario	10.8
Province Of Quebec	8.7
Bank of Montreal	3.9
Royal Bank of Canada	3.2
<b>Total</b>	<b>61.5</b>

### Geographic allocation



### Term distribution (years)



Bond rating	Tactical Bond Strategy	FTSE Canada Universe Bond Index
AAA	38%	40%
AA	21%	36%
A	35%	13%
BBB & Below	6%	11%
<b>Total</b>	<b>100%</b>	<b>100%</b>

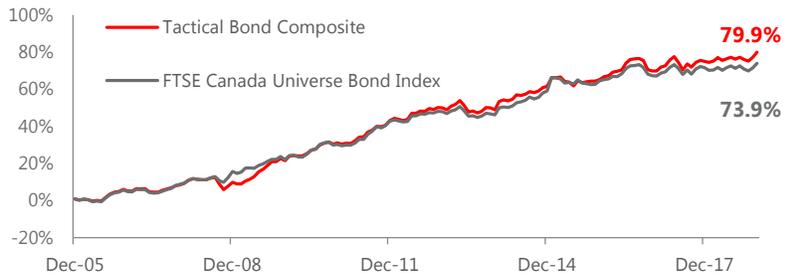
Excludes cash

## Highlights

Inception	January 1, 2005
Strategy AUM	\$129 MM
Liquidity	Segregated: Daily / Pooled: Weekly
Holdings	77
Currency	Discretionary hedging
Benchmark	FTSE Canada Universe Bond Index

## Performance

### Cumulative returns (%)



Compound returns (%)	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	7 yr	10 yr
Composite	1.50	2.25	1.57	2.79	2.90	3.86	3.33	5.07
Benchmark	1.36	1.76	0.79	1.41	1.86	3.54	2.86	4.16
<b>Value add</b>	<b>+0.14</b>	<b>+0.48</b>	<b>+0.78</b>	<b>+1.38</b>	<b>+1.04</b>	<b>+0.32</b>	<b>+0.47</b>	<b>+0.90</b>

Calendar returns (%)	2017	2016	2015	2014	2013	2012	2011	2010	2009
Composite	3.05	2.86	2.28	8.45	-0.73	4.84	9.16	7.99	10.55
Benchmark	2.52	1.66	3.52	8.79	-1.19	3.60	9.67	6.74	5.41
<b>Value add</b>	<b>+0.53</b>	<b>+1.20</b>	<b>-1.24</b>	<b>-0.34</b>	<b>+0.46</b>	<b>+1.24</b>	<b>-0.51</b>	<b>+1.24</b>	<b>+5.14</b>

## Comparative analysis

	Tactical Bond Strategy Guidelines	Tactical Bond Strategy	FTSE Canada Universe Bond Index
Cash & Equivalents	0-30%	2.3%	-
Federal Bonds	0-100%	34.9%	36.3%
Provincial Bonds	0-100%	26.3%	34.0%
Corporate Bonds	0-60%	40.8%	27.7%
Real Return Bonds & US TIPs	0-25%	1.9%	-
Canadian Exposure	80-100%	91.1%	100%
Foreign Exposure	0-20%	8.9%	-
Hedges & Derivatives	0-100%	95.6%	-
Yield to Maturity*	-%	2.69%	2.72%
Duration	+/- 2 years	7.54 years	7.57 years
Average Credit Rating	Min BBB-	AA-	AA
Holdings	-	77	1,464

Source: 1832 AM, FTSE Global Debt Capital Markets

\*Total yield adjusted for futures

Scotia Institutional Asset Management™

Performance returns for the Scotia Tactical Bond 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 Tactical Bond Fund. There is no guarantee that the Strategy would have invested in the same holdings as the Fund, and actual performance would have been 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.

## Quarterly commentary (as of December 31, 2018)

### Romas Budd, MBA, Vice President & Portfolio Manager, Fixed Income



Canadian fixed income investors were on track to lose money in 2018 heading into the final quarter of the year but increased market volatility and the equity market sell-off drove investors back into the fixed income market to generate positive returns for the year. The FTSE/TMX Canada Universe index rose by 1.76% in the quarter and finished the year with a 1.41% return. Both the Bank of Canada and the U.S. Federal Reserve lifted short-term policy rates in the quarter as both central banks are looking to normalize interest rates. Federal Reserve Chair Jerome Powell's comments in early October about overnight rates being "a long way from neutral" contributed to the equity market nervousness and ultimately a decline in longer term interest rates. The yield on the 10 year Canadian government bond fell by 46 bps in the quarter and finished at 1.97%, which was the lowest level of the year.

Spreads on both provincial and corporate bonds widened significantly in the quarter, with Canadian investment grade spreads finishing 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. Long dated Canadian federal government bonds were the best performing segment of the market in the quarter as they finished higher by 4.7%. Inflation linked bonds were the worst performing sector, declining by 1.1% as future inflation expectations collapsed due to the fall in the price of oil. Long date inflation expectations fell by 34 bps and finished the year at 1.42%, well short of the Bank of Canada's inflation target of 2%.

The fund's net long duration exposure added in October had a positive impact on performance as yields declined. Curve positioning was a contributor to performance as the long end of the curve steepened. The fund's underweight exposure to Provincial securities was a significant positive contributor to performance as spreads widened. Overall, the fund outperformed its benchmark. During the third quarter the fund exposure to the AUD and NZD were unhedged to take advantage of the attractive valuations against the CAD. The fund unwound those exposures during the fourth quarter and is now fully hedged on the AUD and NZD.

Even though investors may be expecting higher bond rates in 2019, management is positioned for the two-year bond bear market to at least hit the pause button. The global economy is being impacted by increased trade tensions and the end of very easy central bank policies. Inflation has likely peaked and will trend down into 2019. The Federal Reserve and the Bank of Canada are likely done or very close to finishing this recent rate-hiking cycle. Risk assets, including credit-based securities, are likely to underperform returns for the government bond market. A surprise for 2019 could be that returns for the bond market will trend better than most expect.

## 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.

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