Actively managed Canadian corporate bond portfolio focused on generating an attractive yield while managing risk

What's the strategy?

The Corporate Bond (Portico) portfolio strategy invests primarily in investment-grade Canadian corporate bonds (rated BBB or higher), diversified across a wide range of both industry sectors and credit quality.

What's the approach?

The portfolio manager pursues a consistent, measured and disciplined approach to capture incremental gains through a multi-factor approach to analyzing interest rates, credit markets and yield curves. The portfolio manager of this actively managed fixed-income portfolio focuses on risk management and generating an attractive yield. Within well-defined risk parameters, the portfolio manager has the flexibility to add exposure to high-yield bonds and foreign-denominated bonds in select holdings when attractive market conditions exist.

Why invest in this portfolio strategy?

Ideal for investors seeking additional yield opportunity (above that of Canadian government bonds) through investment-grade corporate bonds scrutinized for their credit quality fundamentals and attractive relative value.

This actively managed portfolio also offers a reduced sensitivity (when compared to a core bond portfolio) to the negative effects of rising interest rates on bond prices; this is due to the additional yield cushion and typical shorter duration of the portfolio.

Typical portfolio characteristics

The Corporate bond (Portico) portfolio strategy offers investors a fixed income alternative that generates a higher income than a typical core Canadian bond fund. This portfolio strategy can offer:

- A diversified Canadian fixed income portfolio of corporate bond holdings across a wide range of industry sectors and credit quality.
- Additional yield opportunity (above that of Canadian government bonds) through investment-grade corporate, with the additional flexibility to invest in non-investment grade corporate debt and foreign-denominated debt in select holdings when attractive market conditions present.
- A reduced sensitivity (when compared to a core bond portfolio) to the negative effects of rising interest rates on bond prices.
- Active fixed-income portfolio management and proprietary credit analysis to capitalize on yield opportunities and minimize portfolio risk.

Strategy snapshot

Asset class
Fixed Income

Inception date
2001

Assets in mandate
$1,362.3 million

Benchmark
FTSE Canada All Corporate Bond Index

Investment team
Portico Investment Management

Portfolio manager(s)
Ian Whiteside
Vice-President, Fixed Income

About GLC

GLC Asset Management Group Ltd. (GLC) is a leading investment management firm that manages more than $50 billion in assets.

GLC has 5 investment management divisions:

- GWL Investment Management
- London Capital Management
- Laketon Investment Management
- Portico Investment Management
- Portfolio Solutions Group

Each division has a distinct investment approach that offers deep expertise within specialized areas of portfolio management, bringing unique perspectives to navigating capital markets through varying cycles.

As at December 31, 2018

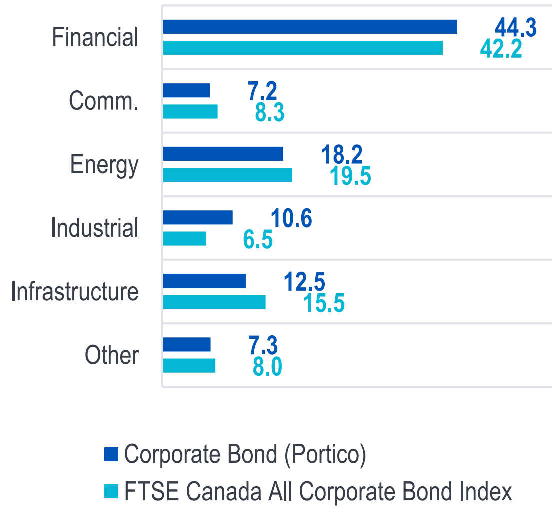
Portfolio attributes

	Portfolio[1]	Index[2]
Average term (years)	8.13	8.60
Modified duration (years)	5.89	6.14
Market yield (%)	3.48	3.44
Number of Bonds	131	974

Credit quality %

	Portfolio[1]	Index[2]
AAA	0.0	2.4
AA	19.9	26.2
A	38.3	33.3
BBB	39.8	38.1
<BBB	1.9	0.0

Sector Allocation %



Source: GLC, FTSE Global Debt Capital Markets | 1. Fund: LL - Corporate Bond Fund (Portico) | 2. Index: FTSE Canada All Corporate Bond Index

Portfolio manager's quarterly commentary

As at December 31, 2018

Market review

The FTSE Canada Universe Bond Index returned 1.76% (total return) for the fourth quarter of 2018, bringing the calendar year return back into positive territory at 1.41% (total return). North American bond yields fell sharply as investors embraced a 'risk-off' stance. This coincided with a broad global equity selloff amid concerns of slowing global growth and continued trade tensions between the U.S. and China. In December, the U.S. Federal Reserve (Fed) hiked rates for the fourth time in 2018 but bond yields fell as the Fed signaled it may adopt a slower, more gradual path going forward. The Bank of Canada also hiked rates in October, bringing the total number of hikes to three in 2018. However, Canadian interest rates fell across the curve in the quarter, weighed down by dovish commentary from Governor Poloz and mirroring the fall in U.S. bond yields.

Canadian government bonds outperformed relative to corporates. Corporate bonds produced a positive return despite spreads widening during the quarter. Federal bonds beat provincial and municipal bonds within the government sector. On a term basis, mid-term bonds led the way, followed by long bonds and then short-term bonds.

Portfolio performance

The fund underperformed the FTSE Canada All Corporate Bond index on a gross return basis for the quarter. The key factors contributing to that underperformance were: the fund's security selection, notably in names where the fund has longer duration exposure such as Manulife, Hydro One, Enbridge, Loblaws, and GTAA; and, being overall shorter duration as interest rates rallied during the quarter. Partially offsetting this underperformance was industry positioning, notably being underweight in five-year financial bonds and underweight in long energy bonds which contributed positively to the fund's returns.

Portfolio activity

We participated in several new issues during the quarter. Within the Energy sector, we added long Fortis BC Energy Bonds ('A' rated), which provided name diversification among the long bonds owned by the fund. We also added five and ten-year Loblaws bonds on new issue ('BBB' rated, Industrial), which came with an attractive new issue discount. Lastly, the fund added a ten-year bond issued by TransUrban ('BBB' rated, Infrastructure), an operator of toll roads in Australia, the United States, and Canada. That bond came with an attractive discount relative to domestic peers.

From a credit quality perspective, participating in new issues resulted in a similar credit quality to prior quarter end. The fund's duration relative to the index was decreased near quarter-end in anticipation that interest rates, which had fallen during the quarter, may reverse some of that gain into the new year.

Positioning & outlook

The latter two months of 2018 exhibited a strong risk-off tone, with corporate spreads widening to levels not seen since oil prices collapsed in 2014/2015. The risk-off tone of the market was driven by political risks coming to the fore, concerns regarding slowing global economic growth, and escalated foreign trade disputes, to name a few. Overall, spreads on corporate bonds widened while interest rates fell, with lower quality bonds being hit harder than higher quality bonds; a classic flight-to-quality scenario. Going forward, we expect that spreads on corporate bonds will check back from their peak in December; however, spreads will not likely return to levels that predominated for much of 2018 given what seems to be slower global growth and continued political uncertainty. We believe the Fed will continue raising short-term interest rates as it continues along the path to full normalization, but that path may take longer than initially thought. Similarly, we expect the Bank of Canada to continue to raise short-term interest rates, but at a slower rate than previously thought. We remain cautious of the risks that have the potential to cause another market correction in credit markets, such as escalated foreign-trade disputes, geopolitical risks, emerging market contagion etc., and that these risks may keep interest rates range bound in the shorter term.

Near the end of the fourth quarter of 2018, in response to the decrease in interest rates, we reduced the fund's duration relative to the FTSE Canada All Corporate Bond Index in expectation that rates will rebound from the relatively low levels at the end of the year. In the longer-end of curve, the fund continues to have a bias towards high quality bonds, and will continue to switch to higher quality bonds when valuations are attractive. In the mid- to shorter part of the curve, the recent risk off tone has presented buying opportunities in higher-yielding bonds where the risk/reward profile is favourable. From a sector position, the fund has an overweight bias towards financials, particularly insurance issues based on rates continuing to rise. The fund also has an overweight position in industrials, particularly within the consumer segment (grocery). We continue to be opportunistic in adding new issuers/issuances into the portfolio where credit quality and yield suggest that they will add value. We remain confident in the quality of the credit issues within the portfolio and we believe the portfolio is well-diversified across sectors and industries.