A long term investment opportunity that can help protect your purchasing power

What's the strategy?

The Real Return Bond (Portico) portfolio strategy invests primarily in a select number of high-quality Canadian government real return bond securities where coupon and principal are indexed to inflation. The portfolio invests in bonds that are backed by the federal government.

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, and yield curves. This strategy aims to provide investors with a steady flow of interest income while supplying a hedge against the risk that inflation presents to bonds.

Why invest in this portfolio strategy?

Ideal for investors seeking protection from the eroding effect of inflation by investing in a portfolio of real return bonds.

Typical portfolio characteristics

The Real Return Bond (Portico) strategy can offer:

- Protection for long term purchasing power (as coupon and principal amounts vary with the rate of inflation, the portfolio's returns can help hedge against rising inflation)
- Reduced credit risk through a portfolio of select, high-quality government bond securities held for their relative attractiveness
- Lower interest rate/inflation sensitivity over the longer term than a long-term Canadian government bond portfolio
- A pure Canadian, longer-duration investment to match investors' long-term liabilities and/or meet longer-term objectives
- A unique opportunity to further diversify a fixed-income portfolio

Typical portfolio characteristics include higher short-term return volatility due to longer duration and changing inflation rate expectations. The portfolio tends to have a lower market yield than the broad Canadian fixed-income market, but in contrast to conventional bonds, it benefits from price appreciation due to increases in Canada's consumer price index.

Strategy snapshot

Asset class
Fixed Income

Inception date
2013

Assets in mandate
$361.5 million

Benchmark
FTSE Canada Real Return Bond Index

Investment team
Portico Investment Management

Portfolio manager(s)
Alexa Richardson
Assoc. Manager, 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

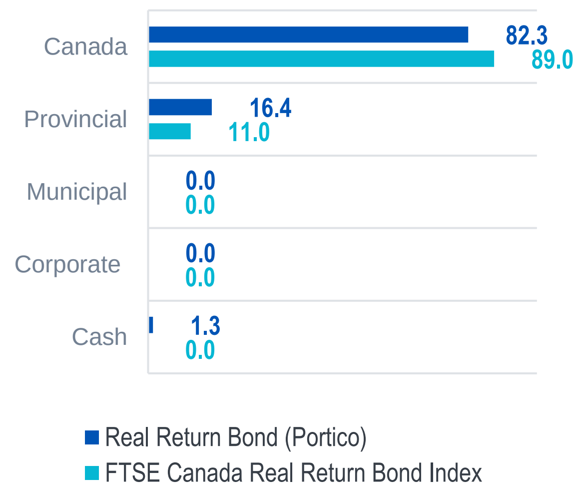
Portfolio attributes

	Portfolio[1]	Index[2]
Average term (years)	17.41	17.38
Modified duration (years)	14.74	14.68
Market yield (%)	0.84	0.79
Number of Bonds	14	14

Credit quality %

	Portfolio[1]	Index[2]
AAA	83.4	89.0
AA	16.6	10.8
A	0.0	0.2
BBB	0.0	0.0
<BBB	0.0	0.0

Sector Allocation %



Source: GLC, FTSE Global Debt Capital Markets | 1. Fund: LL – Real Return Bond Fund (Portico) | 2. Index: FTSE Canada Real Return 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 signalled 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.

Break-even rates (the difference between the yield on a nominal fixed-rate bond and the real yield on an inflation-linked bond of similar maturity and credit quality) dropped over the quarter quite significantly. Real rates decreased slightly, and inflation-linked real return bonds underperformed nominal bonds over similar terms. The FTSE Canada Real Return Bond index returned -1.11% (total return).

Portfolio performance

The portfolio matched the FTSE Canada Real Return Bond index on a gross return basis over the quarter. The fund holds an underweight position in Government of Canada RRBs, which underperformed the overall index, contributing positively to returns. The fund's positioning along the curve also benefited the fund. Holding an overweight position in Provincial RRBs contributed positively to fund performance, as the fund gained on a higher running yield. Being slightly long duration versus the RRB index detracted from relative returns slightly as the market sold off.

Portfolio activity

We continued to add weight to the 2050 RRB Bond and look for opportunities to add to or diversify the fund's provincial exposure. The fund's duration remains very close to neutral versus the index.

Positioning & outlook

The decrease in oil and equity prices in Q4, along with the softening central bank tone in both Canada and the United States, have led to concerns about inflation going forward. This was reflected in a decrease in break-even rates over the quarter. While headline CPI had both positive and negative surprises during the quarter, from a core perspective (which the Bank of Canada watches more closely) the average of the three measures has decreased slightly to the 1.9-2.0% range, but remains right at the mid-point of the Bank of Canada's target rate. This disconnect in break-even rates and core CPI inflation make RRB valuations look attractive. We will continue to monitor future central bank moves and economic releases that may signal inflation may be weakening.

We have strategically positioned the fund to be close to neutral in duration relative to the RRB index and we will tactically manage the fund's duration if interest rates move higher. The fund is targeted for investors with a long time horizon as the fund is linked to the long-term level of inflation. It is important to note that given the structure of inflation-linked bonds, even small changes in real yields can have a significant impact on the short-term performance of the fund.