# Earning interest while limiting credit risk

## What's the strategy?

The Government Bond (Portico) strategy invests primarily in Canadian federal, provincial and municipal government bonds and/or debt products guaranteed by government authorities with a credit rating of A or higher. This portfolio's strategy is designed to earn interest income with limited credit risk.

## What's the approach?

The portfolio manager pursues a consistent, measured and disciplined approach to capture incremental gains within government bond sectors through a multi-factor approach to analyzing interest rates and yield curves.

The portfolio's duration is typically shorter than the broad Canadian bond market as measured by the FTSE Canada Universe Bond Index.

## Why invest in this portfolio strategy?

Ideal for investors seeking a conservatively managed Canadian fixed-income strategy for income generation.

When compared to the broad fixed-income market, this high-quality bond portfolio offers:

- Reduced credit risk
- Less interest rate sensitivity (due to the shorter duration of the portfolio)
- A greater opportunity for capital preservation
- The potential for long-term capital appreciation

## Typical portfolio characteristics

Here's what you can expect to see from Portico's Government Bond fixed income strategy when compared to its Canadian benchmark:

- 2 to 5 year average term range
- Minimum A credit rating (at purchase)

## Strategy snapshot

**Asset class**
Fixed Income

**Inception date**
1994

**Assets in mandate**
$145.0 million

**Benchmark**
80% FTSE Short Term Government Bond Index
20% FTSE Canada Mid Term Government Bond Index

**Investment team**
Portico Investment Management

**Portfolio manager(s)**
Janet Salter
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 June 28, 2019

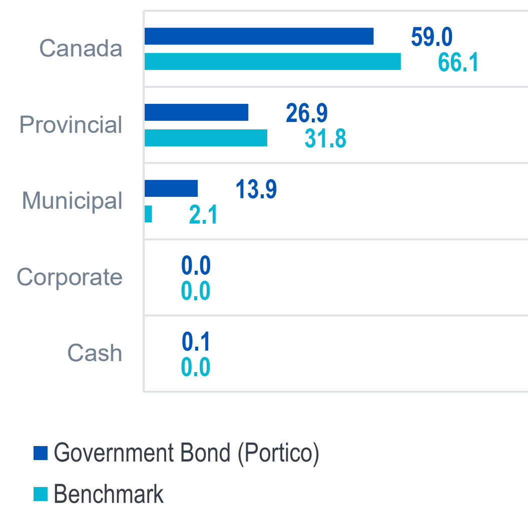
## Portfolio attributes

| | Portfolio[1] | Index[2] |
|---|---|---|
| Average term (years) | 3.87 | 3.89 |
| Modified duration (years) | 3.61 | 3.61 |
| Market yield (%) | 1.71 | 1.66 |
| Number of Bonds | 39 | 278 |

## Credit quality %

| | Portfolio[1] | Index[2] |
|---|---|---|
| AAA | 67.8 | 69.4 |
| AA | 30.1 | 27.7 |
| A | 2.1 | 2.8 |
| BBB | 0.0 | 0.0 |
| <BBB | 0.0 | 0.0 |

## Sector Allocation %




Source: GLC, FTSE Global Debt Capital Markets | 1. Fund: LL - Government Bond Fund (Portico) | 2. Index: 80% FTSE Short Term Government Bond Index, 20% FTSE Canada Mid Term Government Bond Index

# Portfolio manager's quarterly commentary

As at June 28, 2019

## Market review

The FTSE Canada Universe Bond Index returned 2.5% (total return) for the second quarter of 2019, marking the third consecutive quarter of strong returns for Canadian fixed-income investors. North American bond yields moved lower, continuing a trend that began in October 2018. Canadian 10-year bond yields were down 15 basis points (bps) for the quarter, while U.S. 10-year bond yields fell 40 bps. The fall in bond yields coincided with a policy shift from various central banks, most notably the U.S. Federal Reserve, which abruptly shifted to a rate-cutting bias after hiking rates a quarter point last December. North American bond yields continue to be weighed down by negative interest rate policies on the part of central banks in Europe and Japan. The Bank of Canada left rates unchanged during the period and provided messaging that suggests rates are on hold for at least the rest of the year. The move in bond yields saw Canadian long-term bonds significantly outperform relative to short-term bonds. Canadian corporate bonds slightly outperformed government bonds. Provincial and municipal bonds outperformed within the government sector.

## Portfolio performance

The fund posted a positive return that outperformed its blended benchmark (80% FTSE Canada Short All Government Bond index and 20% FTSE Canada Mid All Government Index) on a gross return basis for the quarter. The fund's short duration position relative to benchmark over the June index extension, and overweight position in Municipal and Agency credit holdings were the key areas of outperformance.

## Portfolio activity

Fund duration was neutral to the benchmark for most of the quarter with the exception having a quite aggressive short duration position (93%) during June. The June index extension was particularly large, causing the market to become overbought; however, the short duration position was closed within a week. The portfolio continues to hold an overweight position in Municipal and Agency bonds.

## Positioning & outlook

The current Bank of Canada (BOC) overnight rate (1.75% as of June 30, 2019) is above yields offered in the 2-year to 10-year sector of the Government Bond curve. While acknowledging what they see as a “temporary slowdown” and a pause in their tightening cycle, the BOC has insinuated that the overnight rate remains below their neutral target. We intend to maintain an overweight position in credit paper as long as Canadian economic data remains strong. We would tactically run either short- or long-duration positions should the market become dislocated. The U.S.-China trade outcome remains the most concerning unknown in the general global macroeconomic outlook. Currently the U.S. market is pricing-in a significant easing cycle from the U.S. Federal Reserve, despite generally decent U.S. economic data. The reasons for this are twofold: uncertainty over U.S.-China trade and persistently low inflation (now coupled with rapidly declining inflation expectations). While we expect the Fed to cut rates in July, it’s entirely possible that rates have over-reacted in the short end, and that Canadian rates have moved too low in conjunction with American rates. While we favour maintaining a neutral-duration position for now, we expect rates to rise with any pickup in inflation or any firm signals of solid progress on the trade front.