Diversify fixed-income holdings with less interest-rate sensitivity

What's the strategy?

The Mortgage Diversified (Portico) portfolio strategy has a unique design – a hybrid of commercial and Canadian residential mortgage investments, which seeks to generate more income than government bonds of a similar term, while creating a portfolio that is less interest-rate sensitive because of its shorter duration.

What's the approach?

This portfolio strategy leverages the expertise and experience within the Great-West Life (GWL) Commercial Mortgage team. The GWL Commercial Mortgage team sources, underwrites and manages the commercial mortgage deals. The Portico Investment Management team offers capital market expertise, portfolio management oversight and liquidity management. Both portfolio managers pursue tested and strongly vetted processes within a culture of strong risk management.

Why invest in this portfolio strategy?

This unique portfolio strategy is a good complement to traditional bond investments, offers greater diversification through mortgages not typically available to investors and access to highly specialized and experienced portfolio management. Ideal for investors seeking to diversify their fixed-income exposure with a portfolio of high quality mortgages geographically diversified across Canada.

Typical portfolio characteristics

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

- Shorter duration and less interest rate sensitivity than the broad Canadian bond market
- Higher interest income than bonds of a similar term because of the higher yield premium on mortgages
- A very low delinquency rate on its mortgages, which is a testament to the team's rigorous risk management process
- Typical mix of 50% residential, 35% commercial and 15% bonds.

Strategy snapshot

Asset class
Fixed Income

Inception date
1969

Assets in mandate
$1,716.0 million

Benchmark
10% FTSE Canada 91 Day T-bill Index
65% FTSE Canada Short Term Overall Bond Index
25% FTSE Canada Mid Term Overall Bond Index

Investment team
Portico Investment Management

Portfolio manager(s)
Dale Haynes
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

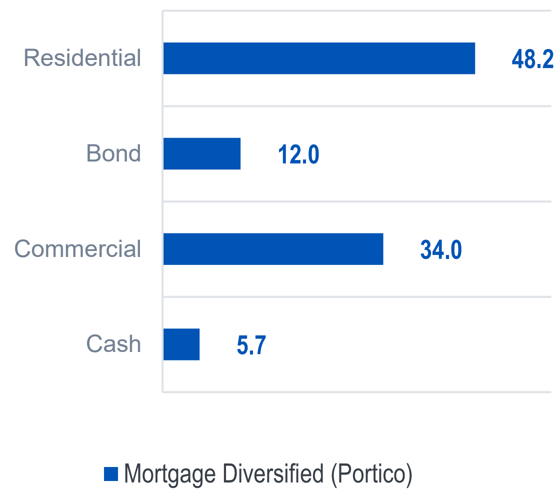
Each division has a distinct investment approach that offers deep expertise within specialized areas of portfolio management, bringing unique perspectives to navigating capital markets through varying cycles.

As at June 28, 2019

Portfolio attributes

	Portfolio[1]
Average term (years)	3.77
Modified duration (years)	3.08
Market yield (%)	2.50
Number of Bonds	14
Regulatory Liquidity	16.1

Sector Allocation %



Source: GLC, FTSE Global Debt Capital Markets | 1. Fund: LL - Mortgage Diversified Fund (Portico) | 2. Index: 10% FTSE Canada 91 Day T-bill Index, 65% FTSE Canada Short Term Overall Bond Index, 25% FTSE Canada Mid Term Overall Bond Index

Portfolio manager's quarterly commentary

As at June 28, 2019

Market review

The market in general continues to strengthen investor appetite for quality commercial mortgages. Associated with that demand has been a corresponding compression in market spreads across most terms. Top-tier conventional ten-year spreads currently range between 160 and 170 basis points (bps), while five-year conventional mortgage spreads range between 150 and 160 basis points. Five- and ten-year CMHC-insured spreads range between 85 and 100 basis points. According to CBRE, the national office vacancy rate has declined by 40 basis points; with substantial tightening in the suburban market with six of the 10 major markets reporting decreases to vacancy. Recovery is ongoing in Alberta with noted improvements to the amount of sublet space on the market, which is returning towards pre-oil recession level. From an investor perspective and driven by continued underperformance in the Energy sector, the fund is not actively looking to add exposure to mortgage opportunities within the Calgary downtown office market. From a geographic perspective, we continue to see strong growth in industrial markets nationally; CBRE reports that demand has outpaced supply for 11 consecutive quarters and the national availability rate has decreased to a new historic record low of 3.0%. To meet user demand for taller clear heights, larger door counts and specialized warehouse configurations, industrial development activity has risen to 22.6 million sq. ft. of space under construction nationally. The demand is the result of warehousing, transportation and logistics requirements from firms looking to expand their distribution networks. Bond yields declined throughout the quarter as the Bank of Canada decided to keep its benchmark interest rate at 1.75% in April. A sharper-than-anticipated slowdown in Canada's oil patch, along with softness in the housing market and consumer spending, led the Bank of Canada to pivot towards a more neutral policy stance.

Portfolio performance

The fund provided a positive return but underperformed its blended benchmark (25% FTSE Canada Mid Term Overall Bond Index, 65% FTSE Canada Short Term Overall Bond Index, 10% FTSE Canada 91 Day T-bill Index) on a gross return basis for the quarter. The attractive market yield on portfolio holdings, versus the benchmark, contributed positively to returns. As evidence of the conservative underwriting standards applied to this fund's holdings, no commercial loans were in arrears.

Portfolio activity

During the second quarter of 2019, $3 million in new commercial mortgages were allocated to the fund at a weighted average spread of 152 basis points and a weighted average term of six years. The portfolio's bond component continues to be maintained to ensure the liquidity of the fund.

Positioning & outlook

The portfolio remains defensively positioned with a focus on high-quality, conservatively underwritten Canadian commercial mortgages that are diversified across Canada by location, property type and borrower. Reflecting the high-quality bias, we seek to opportunistically add commercial mortgage loans secured by institutional-quality real estate, located in major Canadian markets, and with full recourse to the borrowers. The portfolio management team believes the portfolio is well-positioned to acquire and maintain a high-quality, diversified portfolio of commercial mortgages to produce stable and predictable income with minimal default risk. In view of the deteriorating economic conditions in Alberta, the portfolio management team will cautiously approach potential near-term lending opportunities in that province. Instead, the team will look to other areas of the country that are performing well and providing good lending opportunities.