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
$380.5 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 June 28, 2019

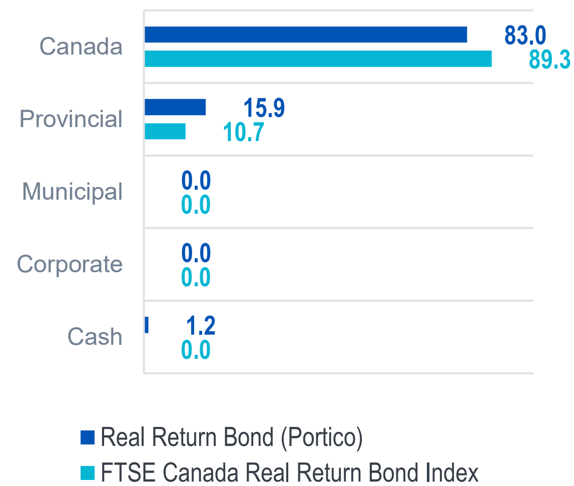
Portfolio attributes

	Portfolio[1]	Index[2]
Average term (years)	17.27	17.40
Modified duration (years)	14.85	14.95
Market yield (%)	0.37	0.31
Number of Bonds	14	14

Credit quality %

	Portfolio[1]	Index[2]
AAA	84.0	89.3
AA	16.0	10.5
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 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 portfolio delivered a positive return that was in line with the FTSE Canada Real Return Bond index on a gross return basis over the quarter (both the fund and the RRB benchmark outperformed the broad FTSE Canadian bond index). The fund holds an underweight position in Government of Canada RRBs (which outperformed the overall index) that slightly detracted from the fund's returns. However, the fund's positioning along the curve contributed positively to performance. Holding an overweight position in Provincial RRBs benefited fund performance, as it gained on the higher-running yield. Being slightly long duration versus the RRB index contributed to relative returns when real yields decreased.

Portfolio activity

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

Positioning & outlook

Break-even rates continued to suppress despite a relatively unchanged equity market and oil price over the quarter. Inflation, as measured by the headline Consumer Price Index (CPI), improved over the quarter and had a positive surprise in June. Core CPI (which the Bank of Canada watches more closely) improved as well with the average of the three measures improving to the 1.9 to 2.0% range, which is just below, or 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'll continue to monitor future central bank moves and economic releases that may signal inflation is weakening. We have strategically positioned the fund to be close to neutral in duration relative to the RRB index and we'll tactically manage the fund's duration if interest rates move higher. The fund is targeted for investors with a long-term time horizon because it's linked to inflation's long-term level. 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.