glc asset management

Real Return Bond
Portico Investment Management

Q2 2020

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
$403.9 million

Benchmark
FTSE Canada Real Return Bond Index

Investment team
Portico Investment Management

Portfolio manager(s)
Alexa Richardson
Manager, Fixed Income

About GLC

GLC Asset Management Group Ltd. (GLC) is a leading investment management firm that manages more than $55 billion in assets.

GLC has 5 investment management divisions:

- GWL Investment Management
- London Capital Management
- Laketon Investment Management
- Portico Investment Management
- Global Multi-Asset Strategy team (including 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 30, 2020

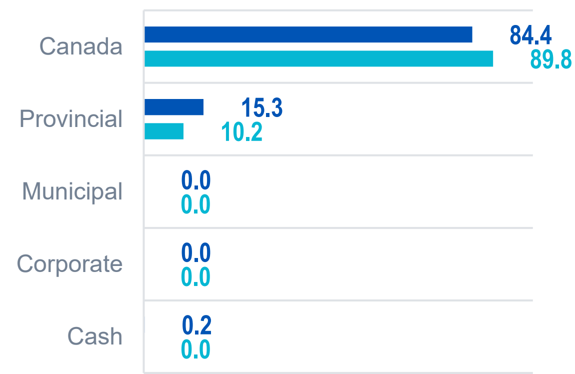
Portfolio attributes

	Portfolio[1]	Index[2]
Average term (years)	17.24	17.04
Modified duration (years)	15.00	14.89
Market yield (%)	0.07	0.00
Number of Bonds	15	14

Credit quality %

	Portfolio[1]	Index[2]
AAA	84.6	89.8
AA	15.4	10.1
A	0.0	0.1
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 30, 2020

Market review

The FTSE Canada Universe Bond Index returned 5.9% (total return) in the second quarter, the third largest quarterly return since 2000. Sovereign bond yields continued their descent to new historic lows, anchored by global central banks keeping their policy rates near zero. Canadian bond yields fell in the quarter, particularly on the longer end of the curve, which resulted in longer-term bonds outperforming their shorter-term counterparts. Canadian corporates outperformed relative to government bonds, strengthened by narrowing credit spreads as economies slowly re-opened. High-yield bonds slightly lagged investment-grade bonds, while provincial bonds outperformed within the government sector.

Portfolio performance

During a period of market recovery, the portfolio posted a strong positive return that slightly underperformed the FTSE Canada Real Return Bond Index (but outperformed the broader FTSE Canada Bond Universe Index) on a gross return basis in the second quarter of 2020. The fund continued to hold an overweight position in Provincial RRBs (specifically Ontario RRBs). The allocation to provincials detracted from performance (and represented nearly all the underperformance for the quarter) as the Federal component of the index outperformed Provincials. The underperformance of Ontario's bond issue was largely related to a repricing of the spread on that specific bond following the RRB buyback in May. The fund was slightly short duration over the quarter, which also detracted slightly from the relative performance versus its benchmark index. The fund benefitted from a slightly higher running yield versus the index. Break-evens have recovered since their dip in March and are now trading in a narrower range and trending slightly higher. As a result, inflation-linked product outperformed nominal product during the quarter, benefiting the fund relative to the broad Canadian fixed income market.

Portfolio activity

The fund's duration remains neutral-to-slightly-short versus the index. The first RRB auction of the year took place in the second quarter, which was accompanied by a buyback by the Bank of Canada of $100mm maximum of each of the other outstanding Federal RRB lines in the index. Compared to other Bank of Canada buybacks, this program was fully taken up. As a result, little changed to the make-up of the index post-auction and very little in index extension as is typically seen after the auctions. During the quarter, we slightly pared back our exposure to provincial bonds (although we remain overweight) and we've added a small allocation toward nominal bonds (in the event of a decline in break-evens).

Positioning & outlook

Inflation, as measured by the year-over-year headline Consumer Price Index (CPI), was depressed in March and April. The May report also came in lower than expected. Annual core CPI has been steadily declining through to the May report. Expectations are that inflation will remain low for the near future and could be kept low with the concerns of a second wave of COVID-19 and uncertainty around the speed of an economic recovery. We have strategically positioned the fund to be close to neutral duration relative to the RRB index. 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 the long-term inflation 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.