
Top Funds Report

Markets rally in September

But the risk of a global economic slowdown clouds the outlook...

After a rocky August that saw investor anxieties rise, most equity markets rebounded, showing positive returns in September. It was once again trade talks between the U.S. and China, and central bank actions that competed for investor attention.

While there were some hopes that progress could be made on the trade front, tweets from U.S. President Donald Trump suggested that he would not be backing down on tariffs on Chinese imports, and that a great deal would need to be reached before he did.

Meanwhile, the U.S. Federal Reserve Board cut its benchmark federal funds rate by 25 basis points at its September meeting. The market is pricing in at least one more rate cut between now and the end of the year.

With the Bank of Canada choosing to stand pat on rates, we saw the loonie strengthen against the U.S. greenback. The dollar fell to \$1.3243 at the end of the month from \$1.3295.

In the eurozone, economic data showed that Germany's economy is stalling and is now on its way into a recession. In reaction, the European Central Bank is also expected to announce a new round of quantitative easing in addition to another rate cut.

Equity markets reacted favourably to monetary easing, with U.S. markets retracing much of their August losses and Canadian markets reaching all-time highs in the month.

The S&P 500 Composite Index gained 1.87% in U.S. dollar terms in September and ended the third quarter higher by 1.7%. When the movement in the Canadian dollar is factored in, the index gained 1.50% in September and 3.04% for the third quarter overall.

The MSCI EAFE Index gained 2.92% in September but ended the quarter 1.0% lower in U.S. dollar terms. In Canadian dollar terms, the index was up 2.54% in September and advanced by 0.31% in the quarter.

Closer to home, the S&P/TSX Composite Index gained 1.69% in September and closed out the quarter 2.48% higher. Energy and financial stocks were the big drivers of return in the month, with the sector indexes gaining 9.4% and 6.8% respectively. The biggest headwind came from the healthcare sector, which lost 7.5% on continued weakness from cannabis stocks.

September was also notable because we saw a very sharp rotation out of the growth and momentum stocks, which have been responsible for much of the recent market gains, and into the somewhat unloved value sectors. Whether this rotation is sustainable remains to be seen, but at some point, we will see the market reward value.

Looking at the fixed-income markets, bonds ended the month mostly lower as yields moved higher on stronger-than-expected economic data in both Canada and the U.S. In Canada, the yield on the benchmark Government of Canada 10-year bond rose to 1.37% from 1.16%.

Short-term bonds held up better than long-term bonds thanks largely to their lower sensitivity to interest rates. And we also saw corporate bonds outperform their government counterparts.

Heading into the final quarter of the year, I expect that trade issues and central bank moves will drive market activity and sentiment. Economic data continue to surprise, but we have seen some signs of a slowdown in the U.S. with weaker ISM Purchasing Manager Index

data released in early September, suggesting that the manufacturing sector is contracting.

I continue to focus on quality, both in equity and fixed income.

For equities, I continue to favour North America, and I am somewhat concerned about Europe. With Germany on the brink of recession and continuing worries about whether the tentative Brexit deal will be approved by Parliament (and its impact if it is), I remain cautious. For fixed income, I continue to focus on North American investment-grade and government bonds. I am underweight high yield issues.

My investment outlook remains consistent as shown in the accompanying matrix.

		Underweight	Neutral	Overweight
Cash			X	
Bonds			X	
	Government		X	
	Corporate		X	
	High Yield	X		
	Global Bonds		X	
	Real Ret. Bonds		X	
Equities			X	
	Canada		X	
	U.S.		X	
	International		X	
	Emerg Markets	X		

Please send your comments to:

feedback@paterson-associates.ca

Funds of Note

This month we look at the fund shakeup at CI, a new CI ESG fund, and RBC's factor-investing fund

CI rationalizes fund lineup

In September, CI Investments announced a massive restructuring of its sprawling fund lineup. It proposed 30 fund mergers, and the renaming of another 19 funds. One of the big casualties of this announcement is the Harbour brand, which will effectively be gone after these mergers take place.

The CI Harbour Fund is being merged into the CI Canadian Investment Fund, while the CI Harbour Global Equity Fund is being combined with CI Global Value.

The Sentry brand, acquired in 2017, was also hit hard, with a number of Sentry mandates being merged into other CI funds. In addition, there were many name changes with several Harbour and Sentry funds being renamed under Signature, Cambridge, and CI banners.

The house-cleaning was necessary. Over the years, CI has significantly expanded its fund lineup, and it had become very cumbersome to navigate.

Another issue I found with CI's lineup is that there was a lot of overlap between the different brands and a lot of similar funds.

This rationalization was certainly long overdue, but it is somewhat sad to see the Harbour brand disappear. It has a rich and storied history.

Portfolio manager Michael Simpson leaves Sentry

In other related CI news, long-time portfolio manager Michael Simpson appears to have left Sentry and CI. Mr. Simpson had a long and successful run at the helm of the Sentry Canadian Income Fund, a fund that despite its recent struggles and disappointing performance, had a strong long-term track record.

In the past couple of years, performance was weighed down by the fund's value-focused style that has been out of favour with investors for the past few years. And since 2016, this fund, which had posted numbers well above average, began underperforming, delivering third- and fourth-quartile returns.

In recent weeks, however, we have seen something of a rotation back into value names. Whether that rotation is sustainable remains to be seen, but it would be expected to be beneficial to the fund.

Another long-time manager Aubrey Hearn, who co-managed funds with Simpson, remains with the fund. Stepping into the co-manager role are Bryan Brown and Jack Hall both Sentry alumni.

I believe the fund remains in competent hands, but my patience is wearing thin. I am particularly frustrated there was no formal announcement from CI that this management change had occurred, especially for a fund that has been around since August 2008.

CI MSCI World ESG Impact Fund (CIG 2114 – Front-End Units, CIG 4114 – Fee-Based Units) CI First Asset MSCI World ESG Impact ETF (TSX: CESG)

Investor interest in funds with an environmental, social, and governance (ESG) focus continues to grow, as fund companies tailor more offerings to meet demand. It's not hard to understand why as mounting concerns over climate change, the environment, human rights, and corporate behavior compete with raw return numbers for the attention of the growing cohort of ESG-sensitive investors.

New products in both mutual fund and exchange-traded fund structures are coming to market with increasing frequency as fund companies compete to fill this new demand.

One of the latest launches is the **CI MSCI World ESG Impact Fund** from CI Investments. It is designed to track the MSCI World ESG Select Impact ex Fossil Fuels Index, an index that invests in leading global companies whose products and services have a positive impact on the environment and society.

But wait, there's more. This offering also avoids companies that have fossil fuel reserves used for energy purposes as well as companies that are involved in severe controversial events.

The fund provides exposure to companies involved in alternative energy, environmental causes, basic needs such as nutrition and affordable housing, and empowerment, which includes education and providing financing for small- and medium-sized businesses.

In addition to fossil fuels, the fund also avoids companies involved in alcohol production, gambling operations and support services, tobacco production, nuclear power generation, and weapons manufacturing.

The underlying index that the fund tracks is still very new, having debuted in July of this year. However, MSCI has created a simulation of the index using the same criteria that is used to select stocks today. Perhaps not surprisingly, the performance of the index roughly matches that of the broader index,

The general message of this is you don't necessarily have to sacrifice returns to invest with an ESG focus. The fund is also available as an ETF, **CI First Asset MSCI World ESG Impact ETF**, trading on the TSX under the symbol CESG.

Perhaps the most attractive part of this new offering is its cost. The management fee for the F-class version and the ETF comes in at a very respectable 0.55%, while the full-freight A class mutual fund units that include an embedded dealer trailer fee show a fee of 1.55%. Administration fees will add another 25 to 30 basis points to the total cost, but still, this fund remains a very attractively priced offering.

This is certainly on my radar. If I have the potential to generate an index-like return while helping to make the world a better place, why wouldn't I consider it?

RBC O'Shaughnessy Canadian Equity Fund (RBF 550 – No-Load Units, RBF 775 – Front-End Units)

With all the recent buzz around “factor investing,” you may get the impression it’s a new phenomenon. Not quite. Factor investing has been around for a lot longer than many people think, and James O’Shaughnessy, the founder and one of the lead managers of this fund was one of the early adopters.

Mr. O’Shaughnessy, Chairman and Co-CIO of O’Shaughnessy Asset Management of Stamford, CT, who is joined by his son Patrick as the other lead manager on this fund, wrote a book called *What Works on Wall Street* back in 1996 that outlines his factor investment process for investors. It has been revised and updated several times since then, and remains a popular investing book.

The fund managers screen the stock universe using several factors that historically have been found in stocks that outperform. These factors include valuation, market cap, momentum, and return on invested capital, which includes dividends, share buybacks, and debt repayments.

Stocks are scored on these factors, and then ranked from most attractive to least attractive. The portfolio is then built from the 150 top-rated names. The focus tends to be more on mid-cap names. Of the 110 holdings listed as of Sept. 30, the top 10 comprised 32% of the fund. Top holdings as of Sept. 30 included Sun Life Financial Inc., Air Canada Class B, Kirkland Lake Gold Ltd., CGI Inc. Class A, and National Bank of Canada.

The fund targets a 20% weighting in U.S. stocks, and any currency exposure is typically fully hedged back to Canadian dollars.

Geographically, at the end of August, the fund held approximately 15% in U.S. equities with the balance in Canadian stocks. Sector weights are determined by their relative attractiveness. So as of Sept. 30, the fund was significantly underweight in telecommunications, utilities, and healthcare, while it has overweighting in financials and materials. Despite this, it still has a bit of a value tilt to it, with valuation levels well below the benchmark and peer group.

This is an all-cap fund, meaning it can invest in companies of any size. The average market capitalization is roughly half that of the index and nearly 60% is invested in small and mid-cap companies.

Unfortunately, with small- and mid-cap and value stocks underperforming, this positioning has hurt the fund’s returns in recent years. Over the past three years, it has delivered an average annual compounded rate of return of 1.9%, trailing both the index and peer group. Year-to-date numbers look better with an absolute return of 10.4% to the end of September. Unfortunately, this still trails the index and peer group. Volatility has also been higher than either the index or peer group, further dampening the risk-adjusted returns.

I don’t believe the recent performance is indicative of the long-term quality of this fund, and I would expect to see it turn around when we see a more sustained rotation back into more traditional value stocks. The question isn’t if performance will turn around, but when it will turn around. The question becomes whether the bounceback will help offset several years of underperformance. I am not sure of that answer.

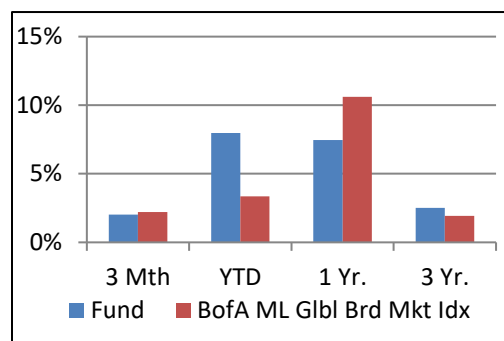
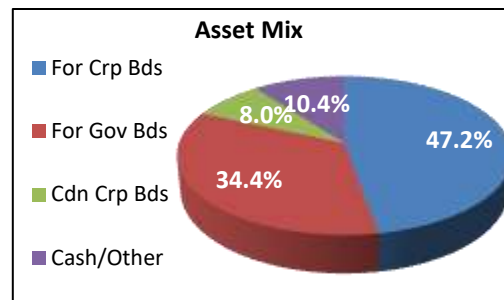
Costs are very attractive, with the fund carrying an MER of 1.49% for the advisor-sold units, which include a 0.65% trailer fee paid to the dealer.

While I have no question that things will turn around for this fund at some point, I also believe there are other funds that offer a more compelling risk-reward profile.

If there is a fund that you would like reviewed, please email a request to me at: feedback@paterson-associates.ca

Invesco Global Bond Fund

Fund Company	Invesco Canada Ltd.
Fund Type	Global Fixed Income
Rating	A
Style	Top-down Macro/Bottom-up Security Selection
Risk Level	Low
Load Status	Optional
RRSP/RRIF Suitability	Fair
Manager	Invesco Global Fixed Income Team since May 2016
MER	1.60%
Fund Code	AIM 4193 – Front-End Units AIM 4195 – Low-Load Units
Minimum Investment	\$500



ANALYSIS: Even with about 25% of the global bond market trading at negative yields, the diversification benefits of global bonds are still worth considering.

Launched in 2016, this global offering from Invesco is managed by the Invesco Global Bond Investment team and headed by Michael Hyman.

The managers use a core-plus investment strategy, with high-quality investment-grade global bonds serving as the core. At least 75% of the fund's portfolio must be invested in the core, which is designed to provide stable income and help protect capital.

For the "plus" side of the strategy, managers have a number of alternatives including high yield issues and emerging market bonds. This sleeve aims to provide a higher level of income as well as potential growth.

While this is a go-anywhere fund, the managers note that North America is one of the few places to find attractive yields. To benefit from this, the fund has 47% of assets invested in U.S. and 7% in Canada. The managers are also finding some good yield-enhancing

opportunities in European corporates, emerging-market sovereign bonds, and non-agency mortgage bonds.

As of Aug. 31, the fund's yield to maturity was listed at 2.7%, while duration was 6.6 years. Duration must be kept within 1.5 years of the benchmark.

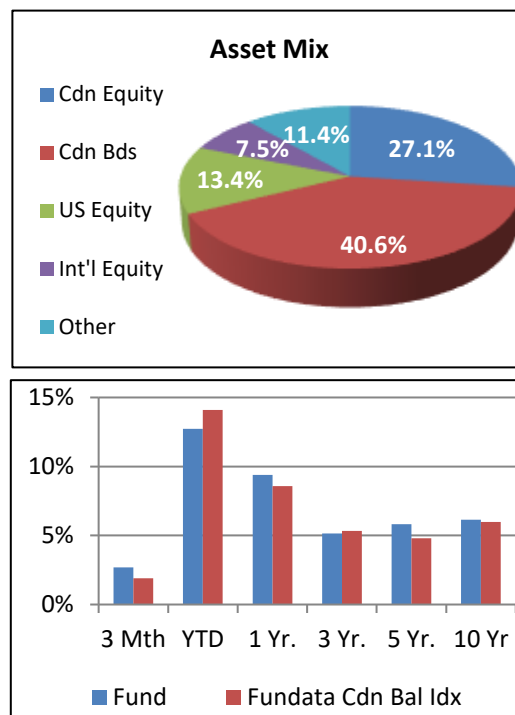
Performance has been above average, with the fund posting a 3-year average annual compounded rate of return of 3.2% to the end of September, outpacing the category average. Volatility has been significantly lower than the peer group with a 3-year average standard deviation of 2.58. The managers are very active, and portfolio turnover levels have averaged more than 350% for the past three years.

Costs are reasonable with the fund carrying an MER of 1.60% for the Class A units, and 0.95% for the fee-based units.

Given the well-resourced investment team and disciplined, repeatable investment process, this is a very strong global bond offering that can play a role in a diversified portfolio.

BMO Monthly Income Fund

Fund Company	BMO Investments
Fund Type	Canadian Neutral Balanced
Rating	A
Style	Top down Macro Bottom up security selection
Risk Level	Low to Medium
Load Status	No-Load
RRSP/RRIF Suitability	Fair
Managers	BMO Management Team
MER	1.57% No-Load/0.69% Fee-based
Fund Code	GGF 70148 – No-Load Units GGF 95148 – Fee-Based Units
Minimum Investment	\$500



ANALYSIS: With interest rates expected to remain low for the foreseeable future and markets pricing in the probability that rates may move even lower, generating income continues to be a challenging task for most investors. Moving entirely to riskier parts of the bond market or switching to dividend-paying stocks both contain market risks in the current environment. Another option might be this balanced fund from BMO, which offers a bit of both.

It aims to deliver stable income while protecting capital and providing the potential for capital gains. It pays a stable \$0.02 per unit monthly and will pay out any capital and other income in December. The annualized distribution yield is currently about 3.5%.

The weighted average yield of the fund falls a bit short of the distribution payout, meaning the managers will need to generate some level of capital gains to help pay the distribution without eroding the capital base.

The fund invests in a balanced portfolio of income-generating equity securities and predominantly investment-grade bonds.

For the equity sleeve, the manager uses a bottom-up fundamental investment process to identify attractively priced securities. It is overweight real estate, utilities, and telecom, with an underweight to energy and financials.

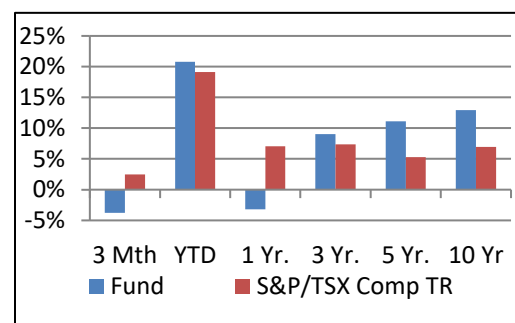
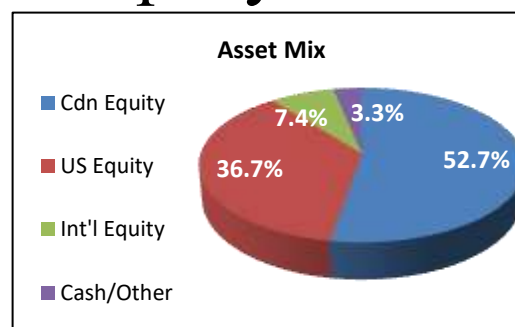
On the fixed-income side, the approach is based on the manager's interest-rate outlook. The portfolio is somewhat neutrally positioned, overweight both the short end and long end of the yield curve, and somewhat underweight the middle part of the curve.

Performance year-to-date has been solid, gaining 12.7% to the end of September, outpacing the index and the peer group. Longer-term numbers are also strong, with a 5-year average annual compounded rate of return of 5.8%. Volatility has been roughly in line with the benchmark and peer group.

Managers have done a solid job protecting capital, participating in nearly all the upside, and less than two thirds of the downside over the past five years. All things considered, this is a decent, conservative balanced offering, that is probably better suited to do-it-yourself investors.

Fidelity Canadian Growth Company Fund

Fund Company	Fidelity Investments Canada
Fund Type	Canadian Focused Equity
Rating	A
Style	Bottom-up Growth
Risk Level	Medium – High
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Mark Schmehl since March 2011
MER	2.25%
Fund Code	FID 265 – Front-End Units FID 865 – Low-Load Units
Minimum Investment	\$500



ANALYSIS: With the recent sharp rotation out of growth stocks and into value stocks, this growth-focused offering managed by Mark Schmehl was hit hard, falling 6.2% in the month, trailing the peer group. Still, year to date to Sept. 30, the fund has gained nearly 21%, and has a 3-year average annual compounded rate of return of 9.0%

Using a somewhat unconventional approach for a growth fund, the manager looks for companies that are undergoing some sort of fundamental change he believes will be a catalyst to unlock share price appreciation and ideally deliver above-average growth over the next 12 to 18 months.

The fund can invest in companies of any size but tends to favour the mid- to large-cap space and can invest up to 49% of assets outside Canada. At the end of August, more than 40% was invested in the U.S.

The bottom-up process results in a sector mix that is a byproduct of stock selection. The fund is overweight technology, healthcare, and consumer-focused names, while dramatically underweight energy and financials, unique for a Canadian equity fund, as those two sectors make up a substantial part of the broader market.

The manager's focus on momentum means the fund is very actively managed, with portfolio turnover averaging more than 240% per year for the past five years. Apart from 2018 and 2016, the fund has delivered top-quartile performance every year since Schmehl began managing it. The tradeoff is that the fund's volatility well above the index and peer group.

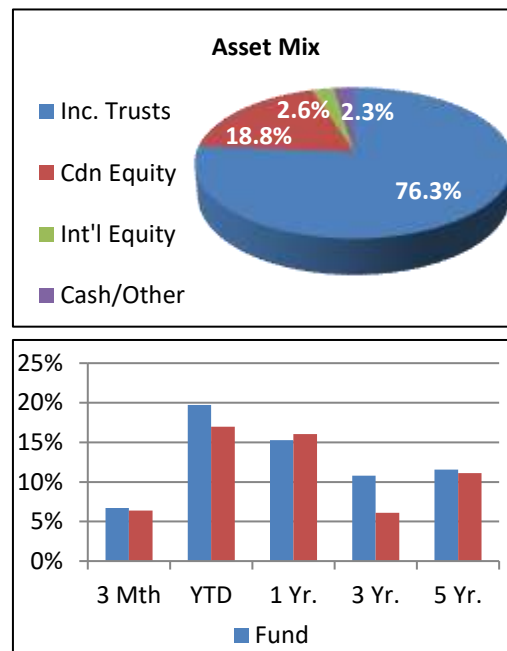
Longer term, Mr. Schmehl has done a solid job protecting capital in down markets, participating in about half the markets declines. However, in recent months, as market volatility has increased, so too has the participation in down markets. In an environment of rising volatility, I would expect to see this fund follow suit, with higher volatility in both up and down markets.

I like this as a growth fund but expect it to be volatile in the coming months. While I'm not fully convinced this most recent rotation away from growth stocks is sustainable, we are going to see a time when it will be, with a larger selloff in growth names.

I would therefore suggest that anyone who has held this fund for some time consider taking profits and protecting capital.

First Asset REIT Income Fund

Fund Company	First Asset Investment Mgmt
Fund Type	Real Estate Equity
Rating	A
Style	Small Cap Value
Risk Level	Medium High
Load Status	Optional
RRSP/RRIF Suitability	Good
Manager	Lee Goldman since July 2010
MER	2.55%
Fund Code	FAF 5803 – Front-End Units FAF 5801 – Low-Load Units
Minimum Investment	\$500



ANALYSIS: This First Asset offering continues to be my favourite fund in the Canadian REIT space. Managed by the team of Lee Goldman and Kate MacDonald, it invests in a mix of REITs and real estate operating companies. It also invests in companies that are involved in real-estate-related services. The focus is on Canada, but it can invest up to 30% in foreign issues. Despite this, the fund sticks pretty close to home, with a very modest 4% invested in the U.S.

The investment process is more value focused, and the managers look for securities that are trading below what they are believed to be worth. The valuation metrics of the portfolio are therefore well below both the index and peer group.

It is an all-cap portfolio, and as of Aug. 31, the fund was focused in small- and mid-cap names. The portfolio is somewhat concentrated, with roughly 40 names and the top 10 making up just under a third of the assets.

This has been the top-performing real estate equity fund over the past three- and five-year periods. As a result, the fund has experienced significant inflows and has nearly tripled in size this year. Assets under management sat at

approximately \$110 million at the end of September. Still, performance hasn't missed much of a beat, as the fund is ahead nearly 20% year-to-date.

The fund has a higher cash holding because of investment inflows but also because the managers are holding cash to take advantage of any market pullback. However, higher cash, particularly in a strong market, is a headwind on performance.

An ETF version is also available (TSX: RIT), very similar to the mutual fund. But you will find a few more smaller-cap names in the mutual fund version.

Costs are high, but reasonable. The MER for the Series A units is 2.55%, which includes a 1% trailer fee paid to the dealer. The fee-based units carry an MER of 1.47%. The ETF comes in at roughly 88 basis points.

I really like this fund, and it remains one of my top picks in the REIT space. The managers follow a disciplined and repeatable investment process, and they have so far handled the influx of new capital with ease. I will continue to watch assets in the fund to ensure there is no meaningful erosion in the risk-reward metrics.