Market and Funds Update

Funds names: Diversified Funds, Global Asset Allocation Funds, Selection Funds, Focus Funds

Portfolio Manager: Managed Solutions team

March 26, 2020

The following is a summary of our investment decisions made during the recent period of financial market turbulence. You will also find information on the general positioning of Diversified Funds, Global Asset Allocation Funds, Selection Funds and Focus Funds.

Diversified Funds

Prior to the equity market correction, the portfolios had a fairly neutral exposure to equity risk when taking into account the many risk management tools in place.

- Long positions in S&P 500 put options
- Long positions in U.S. long term bond futures contracts
- Long positions in gold bullion futures contracts

During the first phase of the correction, we decided to quickly liquidate gold as its negative correlation with the stock market seemed to be diminishing. We also took advantage of our put options and US bonds gradually.

Subsequently, the new shock from the price war between Saudi Arabia and Russia prompted us to favor a neutral to underweight equity position and to avoid any CAD/USD hedging positions. We even temporarily transferred our Canadian cash to the US dollars.

Since mid-March, we have resumed deploying capital into equities, mainly in regions and sectors that we believe offer the best opportunities for returns over the medium term (3-12 months).

- U.S. banks (KRE ETF)
- European banks (EUFN ETF)
- U.S. energy securities (XLE ETF)
- Emerging markets (EEM ETF)

We also increased our exposure to U.S. corporate bonds (LQD ETF, VCIT ETF) following the Federal Reserve's significant announcement regarding the addition of this asset class to their new quantitative easing plan.

We finally increased our hedging positions on CAD/USD. Nearly 75% of our currency exposure is hedged within equities, and 100% within bonds.

Current positioning can thus be summarized as follows:

- Overweight in equities by around 6% compared to bonds
- Low level of cash
- 75% hedging on the CAD/USD exchange rate risk
- Tactical strategy towards U.S. bank stocks, energy stocks and corporate bonds

Global Asset Allocation Funds

The portfolios were fairly neutral in public equities prior to the correction due to the presence of alternative assets.

Alternative assets have had a significant stabilizing effect on fund performance since the end of February, while the vast majority of these asset classes offer positive returns.

Within bonds, higher exposure to U.S. sovereign bonds mitigated the effect of underperformance in corporate and emerging market bonds.

Since mid-March, we have reduced the duration within bonds and significantly increased our CAD/USD hedge positions. Almost 65% of our currency exposure is hedged within equities, and 100% within bonds.

Finally, we recently rebalanced the portfolios recently by selling bonds and buying equities (approximately 2%).

- Decrease in Canadian bonds
- Increase in U.S. stocks

Current positioning can thus be summarized as follows:

- Neutral public equities, with an overweight position in emerging markets
- Underweight in bonds
- 20% exposure to alternative assets
- 65% hedge on the CAD/USD exchange rate risk

Selection Funds

Review of Selection Funds' investment mandate:

- Semi-active funds where the overweight/underweight of equities vs bonds is positioned according to a 6 to 18-month strategic view
- No possibility of using short-term risk mitigation tools (such as options, futures and ETFs)
- The absence of ETFs makes movements within asset classes more laborious, due to underlying manager constraints in times of volatility

The portfolios were overweight in equities and underweight in bonds before the market correction.

After an initial stock market downturn in late February/early March, we took advantage of a technical rebound to neutralize equity risk, while freeing up cash by reducing the weight of bonds.

Subsequently, we let the funds become underweight in equities (drift effect) while the stock markets headed into "bear market" zone with a decline of more than 20% since their peak.

Since mid-March, an opportunistic purchasing program has been implemented to increase the weight of equities, which prioritizes the purchase of U.S. and international equities.

Current positioning can thus be summarized as follows:

- Overweight in equities by approximately 5% as compared to bonds
- Neutral high yield corporate bonds
- Low level of cash

Focus Funds

Review of Focus Funds' investment mandate:

- Passive funds where we rely on the underlying managers to manage risks and add long-term value
- Monthly automatic rebalancing to target allocation

Funds drifted sharply to an underweight position in stocks during the equity market downturn

We have decided to bring forward the rebalancing of funds (normally scheduled for the end of the month) to materialize the positive value added from the drift (about 70 basis points)

In the end, the funds are back to their neutral target and we will continue to rebalance the funds in the most optimal way.

Managed Solutions team