NEO FIXD

MONTHLY COMMENTARY

Evolve Active Core Fixed Income ETF

FIXD invests primarily in domestic and international high quality fixed income securities, and to a lesser extent, adding yield or enhancing returns on the portfolio by opportunistically investing in international fixed income securities, emerging market debt, preferred shares, convertible bonds and non-investment grade bonds.

For the month ending November 30, 2018

TICKER: FIXD

SUB-ADVISOR: Foyston, Gordon & Payne, Inc.

Foyston, Gordon & Payne Inc.
Investment Counsel

Fixed income allocations remain a core component of many investor portfolios as a source of income and portfolio diversification. Foyston, Gordon & Payne Inc. has managed the FGP Core Plus Bond Fund since December 31, 2015.

THE BOND MARKET AND THE ECONOMY:

The equity market volatility experienced in October continued into November with nervousness spreading into the bond and preferred share markets as interest rates fell and corporate credit spreads moved wider after largely shrugging off October's downdraft in equity prices. While there are some signs of economic slowing in the U.S. these remain mostly at the margin and forecasts for the coming year expect only a modest drop from the pace of the past few, post-tax stimulus, months. The Federal Reserve continues to signal that there will be more rate increases, as soon as mid-December, but the tone of these signals has become more modest as market gyrations increased. Accordingly, the market's expectations for the Federal Funds rate have fallen well below those officially indicated by the Fed itself. Canada has shown more signs of slowing but growth, overall, remains solid. The Bank of Canada provides little forward guidance but has been leaning toward a rate increase in January. The Bank has time to further assess incoming economic data, market activity, the impact of the Fed's (as well as their own) past rate hikes, as well as more recent developments such as Alberta's just-announced oil production cut that will temporarily slow growth in that province but also nationally. Resulting from a 'flight-to-safety', the domestic five-year government bond yield fell by over 20 basis points in the month, back to a level last seen in early September of this year.

In Canadian bonds, there has been a rally as a result of declining rates although in the corporate bond space much of this has been offset by widening spreads. While spreads had widened modestly so far this year, the trend has accelerated over the last few weeks. This is positive for the corporate holdings as they had been gradually repositioned over the past year to reduce risk in the corporate bond portion of the portfolio. There is now a good opportunity to selectively add risk in various segments of the corporate bond market and take advantage of the widened spreads.

In November, preferred shares eventually yielded to the widening risk-off sentiment in the Canadian and global markets and saw consistent losses throughout the month. This weakness has been significant and has been driven by contagion from equities with an added impact from increased selling activity from the retail segment of the pref market. The activity from retail investors seems to be skewed towards holdings that were materially down on the year which may imply it is related to tax-loss selling. A benefit of this is that it has translated into dramatically different performance from similar prefs which has set up opportunities that should add value in the future. Over the short-term, we expect that the preferred share market will continue to be heavily influenced by the current risk-off tone in the equity markets but that overall the preferred share market is an increasingly attractive outright buying opportunity.

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PORTFOLIO STRATEGY:

Portfolio duration remains below the benchmark's duration as FGP continues to have an unfavourable long-term view of the bond market's risk/reward characteristics. FGP continues to believe that interest rates remain at a level inconsistent with Canada's economic fundamentals. The portfolio is positioned to perform well against its benchmark from a rising rate environment and from any steepening to the interest rate curve.

The portfolio continues to maintain an overweight position in Canadian corporate bonds as overall credit quality remains in good shape and the domestic economy continues to grow. Corporate credit spreads moved wider during November and remain wide on a year-to-date basis. While lower grade corporate bonds outperformed higher grade issues in recent years, higher quality credit is now the much more attractive segment of the corporate market on a risk/reward basis. We maintain the portfolio's corporate overweight and provincial underweight as the corporate spreads are showing better value given the recent widening in corporate credit. The credit quality of the portfolio's corporate bonds has begun a modest shift to take advantage of recent relative pricing changes.

The Evolve Active Core Fixed Income ETF (FIXD) will maintain its exposure to preferred shares as we see value in the broader preferred share market as it had not fully reflected increases in short-to-mid term government yields over the last 18 months. Additionally, there has been an increasing dislocation between bonds and prefs which has been exacerbated over the last few weeks and 'buy prefs, sell bonds' is now a great relative value trade.