NEO FIXD

QUARTERLY COMMENTARY

Evolve Active Core Fixed Income Fund

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 March 29, 2019

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.

OVERVIEW:

The economic weakness experienced at the end of 2018 carried into the first quarter of 2019. Domestic growth has certainly slowed, weighed down by the combination of lower investment spending, slower household spending and a drop in exports. Further weighing on growth were the usual suspects: global trade tensions and geopolitical uncertainties. Responding to these events, interest rates fell throughout the quarter.

Despite the slowdown, North America economies are still performing adequately despite being expected to slow after the good performance in 2018, particularly in the tax cut-fueled U.S. In contradiction to more than a few financial market pundits, a recession does not appear to be imminent in 2019 even as the central banks in Canada and the U.S. recently indicated that a pause in their respective tightening cycles is warranted. The subject of rate cuts has not been publicly discussed. Certainly, several economic challenges remain over the balance of the year, but the bond market appears to have already priced in a negative outcome.

Shorter-dated yields dropped slightly more than longer-dated yields reflecting the growing sentiment that North American central banks have reached the end of their respective rate hiking cycles. The benchmark 10-year Government of Canada bond yield fell by approximately 40 basis points in the quarter and the two-year to 30-year yield spread widened by almost five basis points.

Credit performed well as both provincial and corporate bonds exceeded the performance of federal bonds as risk assets in the financial markets rebounded from the weakness seen at the end of last year.

During Q1 2019 the credit markets saw a significant change in sentiment and spreads materially tightened across the curve and credit spectrum. The primary factors responsible for performance this quarter were security selection and the credit risk positioning of the ETF. Our corporate bonds delivered solid performance relative to the index despite the relatively defensive positioning for the strategy. At the end of Q4 and beginning of Q1 we began to increase exposure to higher beta securities in the portfolio as they have begun to look more attractive on a risk-adjusted basis. This included purchases of additional subordinated bank debt and new issuances of bail-in deposit notes which have since performed very well.

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Even though risk assets (equities, corporate bonds, etc.) performed strongly to start the year, the preferred share market in Canada has been slower to rebound. We anticipate that in the coming months the market will gradually recognize the high dividend levels of preferred shares (even in the absence of moves higher in key interest rates) and the further improved valuation relative to more widely followed asset classes that have rebounded strongly this year. When viewed with a longer-term investment time horizon we remain quite comfortable with an increased allocation to preferred shares as the asset class is attractively valued and offers a significant yield advantage over other fixed income options available in the market today.

With the duration of the portfolio more than one year below that of the benchmark the aggressive move lower in interest rates meaningfully impacted performance. The benchmark 10 year Government of Canada bond yield fell by approximately 40 basis points in the first quarter and, in a small trend reversal, the 2 year to 30 year yield spread widened by almost 5 basis points.

OUTLOOK AND PORTFOLIO STRATEGY:

Overall portfolio strategy was little changed from the end of 2018. The fund continues to hold increased allocations to both corporate bonds and preferred shares compared to Q4 2018. Additionally, the fund currently has minimal exposure to high yield bonds. While the domestic economy is moderating from the highs in previous years, we continue to expect to see growth in the near term which should work to support risk assets going forward. Further, we remain confident in the credit quality of the individual investments we have made in each of these asset classes. Portfolio duration remains below the benchmark's duration as FGP continues to have an unfavorable 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 in a stable to rising rate environment.