

## 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 May 31, 2018

**TICKER:** FIXD

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



**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.**

### MONTHLY REVIEW:

Economic growth continued to accelerate in both North American economies in May pointing to a stronger second quarter performance than what was seen in the first quarter. Canada is lagging the pace set in the United States as the level of employment, retail sales, industrial production, and housing all remain robust. That being said, the Bank of Canada is expected to increase its overnight rate in July and the U.S. Federal Reserve Bank is expected to continue its path of rate hikes with a move in June. Consumer Price Inflation in both countries remains around the 2% level and both banks have continued to signal their tolerance for a modestly higher level of inflation. The month saw the reintroduction of Eurozone uncertainties as Italy's populist, anti-Euro parties upset financial markets and President Trump continued his protectionist ways with the introduction of more trade tariffs. The countries impacted, including Canada, have all responded with retaliatory tariffs of their own. The level of these are economically minor at this point but with the fate of NAFTA still uncertain and the threat of more trade restrictions from the U.S., this situation does require close monitoring.

During the month of May, the five-year government bond yield was essentially unchanged in Canada and fell about 10 basis points in the U.S.. In Canada, longer-term bonds saw yields fall and the flattening of the Canadian yield curve resumed after its short break. The Evolve Active Core Fixed Income ETF (FIXD) has an overweight to mid-term bonds and will see a meaningful benefit from a steepening of the yield curve.

The portfolio's below-benchmark duration was a drag on performance in May with additional weakness coming from the underweight to government bonds as the segment had strong relative performance to corporates. Modest performance came from security selection of corporate bonds as the corporate holdings outperformed the corporate benchmark during the month.

The most notable event during the month was the proposal by Enbridge Inc to simplify its organizational structure including subsidiaries such as Enbridge Income Fund Holdings, Enbridge Energy Partners, and Spectra Energy Partners. The simplification would eliminate the public US MLP structure, reduce the amount of cash flow leakage through dividends to public shareholders of the subsidiaries, and provide Enbridge Inc with a much simpler financing strategy for its capital plans. The proposal also stated that the company would eliminate the structural subordination of certain debt and simplify the structure for debtholders. This translated into a meaningful rally in spreads of Enbridge Income Fund Holdings debt which is a holding in FIXD.





Preferred shares provided a continued yield enhancement while also generating modest capital appreciation in May that supported performance. The preferred share holdings provide a reduction in the portfolio's sensitivity to movements in interest rates which is a meaningful benefit in the current yield environment.

## 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. The duration position was reduced during the month as we continue to believe that interest rates remain at a level inconsistent with Canada's healthy economic fundamentals. The portfolio is positioned to perform well against its benchmark from a rising rate environment and also from any steepening to the interest rate curve.

The FIXD 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 have widened in 2018 which modestly improves the relative value. While lower grade corporate bonds outperformed higher grade issues in recent years, we expect that 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 still showing better value given the significant rally in provincial spreads in 2017. The credit quality of the portfolio's corporate bonds continues to improve.

An overweight exposure to the domestic bank and life insurance sectors remains in place and these securities have continued to perform very well despite the lingering concerns over consumer indebtedness and exposure to the real estate sector. Higher interest rates are also seen as a positive influence on these sectors. Quality will continue to be emphasized.

The Evolve Active Core Fixed Income ETF will maintain its exposure to preferred shares as we see value in the broader preferred share market as it has not fully reflected increases in short-to-mid term government yields over the last 12 months. Currently, there appears to be modest value in certain rate-reset and floating rate securities that react favourably to rising rates and offer an attractive risk/reward balance. These securities will continue to have an overweight position and when combined with a higher yield than the index should provide additional support for the fund even if the market expectations for interest rates are not fully realized.



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