

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 July 31, 2018

TICKER: FIXD

SUB-ADVISOR: Foyston, Gordon & Payne, Inc. ("FGP")



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.

ECONOMIC OVERVIEW:

Economic growth continued to accelerate in both Canada and the United States throughout July. Second quarter GDP for the U.S. came in at a strong +4.1% and Canada is forecast to have grown around the 3% level. Both levels of growth are probably unsustainable as numerous economic uncertainties remain – notably the impacts of U.S. trade policy and the pace of monetary policy tightening in both countries – but, overall, growth for 2018 looks to be above the trend of the past few years.

Inflationary pressures have been slowly building this year with headline and core inflation rates in both countries now around the 2% level. Strong job growth and decent wage gains have translated into strong consumer spending that continues to provide the bulk of the economic support. Globally, there has been little change in the outlooks for monetary policy – none of the ECB, Bank of Japan or the Bank of England made any change in policy rates in July although all have modest plans to reverse historically easy monetary conditions. The Bank of England hiked its policy rate at the start of August. The U.S. Federal Reserve Bank is expected to raise rates twice more this year while the Bank of Canada is expected to go one more time.

During the month of July, the five-year government bond yield increased by 15 basis points in Canada and by 11 basis points in the U.S. The increases to rates came predominately at the end of July despite the bank of Canada raising the overnight rate by 25 basis points on July 11.

OUTLOOK AND PORTFOLIO STRATEGY:

The primary factors influencing the performance of the Evolve Active Core Fixed Income ETF ("FIXD") were the ETF's above-index exposure to corporate bonds, an underweight exposure to provincial and federal government debt, and a below benchmark duration positioning. In addition to the positive impact of being overweight corporate bonds security selection in the corporate bond space also generated meaningful outperformance.



Preferred shares provided a continued yield enhancement in July while also providing modest capital appreciation. 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.

Overall portfolio strategy was little changed from the end of Q2. 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 healthy 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 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. While already high quality, the credit quality of the portfolio's corporate bonds continues to improve.

FIXD 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 ETF even if the market expectations for interest rates are not fully realized.



Ryan Domsy
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Foyston, Gordon & Payne Inc.

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Investment returns and assets under management are expressed in Canadian dollars unless otherwise noted. Investment returns are gross of investment management fees, net of fund expenses for FGP pooled funds, and include reinvestment of dividends and income. Returns are time weighted and annualized for periods greater than one year. Values change frequently and past investment performance may not be repeated. Securities mentioned herein are not to be construed as recommendations to buy or sell and are not representative of Foyston, Gordon & Payne Inc. accounts/portfolios as a whole. Any projections in this investment presentation are estimates only and may not be realized in the future. Any information herein describing FGP's pooled funds is for illustration purposes only.