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 July 31, 2019

ETF TICKER: FIXD (Unhedged)
MUTUAL FUND FUNDSERV CODE: EVF110 (Class F); EVF111 (Class A)
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:

Much of the month of July was spent in anticipation of interest rate announcements from a number of central banks around the world – from the Fed and the ECB in particular. The ECB did not lower rates further into negative territory on July 25th but signalled that it soon would. The Fed cut its rate by 25 basis points on July 31st, disappointing financial markets that had some expecting a 50 basis point reduction and very few expecting the somewhat hawkish press conference that the Fed chief, Jerome Powell, held following the announcement.

So, despite a positive month overall for the S&P 500, and another new all-time closing record high for the index on July 26th, equity markets fell dramatically to end the month. The TSX fell in sympathy and ended the month almost unchanged from the end of June. Little progress has been made on the laundry list of problems that do have global economic implications – China/U.S. trade, a no-deal Brexit, growing tensions with Iran – and to that list a couple of more have been added: the clear economic slowdown across Europe, Germany in particular, as well as the increasingly violent standoff between Hong Kong and China. Needless to say interest rates fell globally and, as the month ended, the number of investment-grade bonds trading with a negative yield surpassed $14 trillion.

Economic fundamentals have taken a back seat to the flow of funds around the world and those flows are not overly sensitive to the positive growth seen in the U.S. in the second quarter or the surprisingly strong growth seen in Canada with a core inflation rate above the Bank of Canada's target. At least the Bank of Canada can sit comfortably on hold for now while the continued pressure on the Fed for further rate cuts is intense. The benchmark five year Government of Canada bond yield actually increased marginally during the month, up about 5 basis points to 1.46%

The broader Canadian bond market had an eventful month as both rates and spreads experienced volatility. That being said, there are a number of variables that remain unchanged from the most recently released updates – a moderating global growth environment, subdued (but still positive) inflation profiles across the developed world, and a market obsessively focused on the short term news cycle and trade tensions between global leaders.

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Corporate credit performed well over the course of the month, however, there was some volatility just as the month ended as the market reacted to surprises on the global trade front and a fed cut that was smaller and more hawkish than some of the market expected. The provincial segment of the market performed well from a spread perspective but lagged slightly from the rate move as a result of the sectors long duration.

With credit markets seeing continued strength we continued de-risking the portfolio. Our corporate bonds performed well despite the relatively defensive positioning for the strategy. We have been decreasing our exposure to higher beta securities as they look less attractive on a risk-adjusted basis.

The Canadian preferred share market firmed up in July as sentiment about the continuation of the current economic cycle improved after the Fed made it clear that it would follow through on an easing policy stance. However, the renewed escalation of trade tensions will likely limit additional positive moves in the short term in most risk assets (equities, prefs, etc). Despite the continued uncertainty in the markets the outlook for preferred shares continues to be positive driven mostly by the significant yield relative to other asset classes. With a 5.9% dividend yield as a starting point, return expectations for pref portfolios are quite elevated.

The primary driver of performance through a cycle for this strategy is security selection, not interest rate anticipation. The portfolio is constructed based on thorough credit research and associated valuation methodologies to identify undervalued securities relative to the market. The fund's strategy continues to focus on lower risk companies and credit risk-adjusted returns. We expect this asset class to revert to a more properly priced environment as sentiment improves towards the space from stability in the economic data. Currently the pricing dislocations are extremely elevated implying there will be significant opportunity for added value in the coming years.

With the duration of the portfolio below that of the benchmark the interest rate moves essentially had a negative impact on relative performance. This is because the benchmark 5-year Government of Canada bond yield finished the month slightly higher but the longer end of the curve fell modestly.

OUTLOOK AND PORTFOLIO STRATEGY:

Overall portfolio strategy was little changed throughout the month. The fund continues to hold increased allocations to both corporate bonds and preferred shares compared to 2018. Additionally, the fund currently has minimal exposure to high yield bonds. While the domestic economy has moderated from the highs in previous years, we continue to expect to see positive 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 about 1.5 years 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.