NEO FIXD

MONTHLY 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 September 30, 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:

The Canadian economy, thus far, has weathered the trade war storm reasonably well. With many economies reporting weak second quarter activity – especially in manufacturing and trade – Canadian GDP advanced by a healthy 3.7% led by gains in industrial production and net exports. Housing has made a comeback too, supported by lower borrowing rates. The third quarter, however, won't look as good because the reality of slowing global growth has had a negative impact. Combined with flat retail sales growth and continued high levels of consumer indebtedness, it is easy to conclude that growth will indeed slow. The Bank of Canada (BoC) appears to be content being patient with monetary policy – not wanting to re-inflate the housing market by lowering interest rates at a time when headline and core inflation rates are either at or above target. Also, the U.S. Federal Reserve's seeming reluctance for further easing removes pressure on the BoC to act. The market has priced in only a 25-basis point rate reduction through 2020. It would take a serious downturn in the economic data or the global economic backdrop for the BoC to reconsider its position.

MARKET INSIGHTS:

Amid a consistent economic backdrop in Canada, global geopolitics led to heightened volatility in the Canadian bond market during the quarter. In fact, long bonds prices in Canada experienced the highest level of volatility in a generation. Despite this, there was remarkably little change in the yield level of the FTSE Canada Universe Bond Index quarter over quarter. At September 30th the index yielded 2.12%, down just one basis point from its June 30th yield of 2.13%. In contrast, the 30-year Government of Canada bond yield fell by 50 basis points from mid-July to mid-August, resulting in a price gain of about 11%. The yield then increased by over 40 basis points to mid-September, resulting in a price decline of 8.5%. The most notable net change during the quarter was that long corporate bonds outperformed their shorter-duration equivalents, as the impact from some modest spread widening was more than offset by the reduction in long Government of Canada yields, which fell 16 basis points to end the quarter at 1.53%.

OUTLOOK AND PORTFOLIO STRATEGY:

The duration of the portfolio remains one and a half years below that of the benchmark and the portfolio maintained an underweight position in the long end of the yield curve. This positioning was a drag on performance.

However, it is consistent with our view that long duration corporate bonds remain a risky investment with minimal additional spread for compensation. Our continued focus is on the preservation of capital in this low interest rate environment. Security selection continues to be a positive contributor to the overall portfolio as many of our largest holdings outperformed the benchmark. Provincial exposure remains modestly underweight relative to the benchmark, however this sector had little influence as outperformance relative to federal bonds was negligible on a duration-adjusted basis. Our long-standing strategy of improving the credit quality of our corporate investments also remains in place – this quarter saw a reduction in subordinated bank debt and a subsequent increase in senior bank debt.

As with most risk assets (corporate bonds, equities, etc.) preferred shares had a volatile quarter, although finished essentially flat. This was a slight drag on performance as preferred shares did not keep pace with the modest return of bonds.

We continue to be positioned with an overweight in higher quality corporate bonds and an underweight position in longer-dated issues, as we view the risk-reward trade-off of longer-term bonds and riskier credits as unattractive. The portfolio gains a meaningful yield advantage through a small weight in hybrid securities and an exposure to preferred shares, which both offer yields dramatically above riskier bonds.