

PORTFOLIO MANAGERS:
Desjardins Global Asset Management,
Hexavest

INCEPTION DATE:
August 20, 1986

CIFSC CATEGORY*:
Tactical Balanced

Contributors to performance

→ During Q1 2020, financial markets were hit hard by the COVID 19 pandemic. To respond quickly to the sudden stop in economic activity, the Bank of Canada reduced its key rate by 1.5% in the month of March and applied a series of measures to help the bond market's liquidity. The two- to ten-year interest rate curve sharpened by 0.27% and the Canadian government ten-year rate ended at 0.7%, down 1% during the period. In this environment, the portfolio maintained a longer duration than its benchmark, with a bias for securities with seven-year maturities.

Detractors from performance

→ The overweight to corporate bonds was the key detractor from value added, as this sector posted the worst bond market performance over the period. This sector's allocation consists mainly of AA-rated bank securities, which are not cause for concern. However, these securities are invested against provincial and Canadian agency issues. Credit spreads between short-term financial issues and short-term provincials widened from 0.4% on February 20 to 1.67% on March 31.

At the beginning of the year, leading indicators suggested the global economy was in the early innings of a new economic cycle, but the recovery was turned on its head as the covid-19 virus brought Chinese economic activity to a standstill before spreading to other regions of the world.

The severe stock market decline that began at the end of February was the fastest ever recorded. Unlike other global recessions, the one we are currently experiencing was not preceded by warning signs that hinted at economic weakness. The rapid and sharp nature of the current downturn in the global economy and financial markets left almost no chance for investors to position portfolios accordingly.

For the quarter, the portfolio trailed its benchmark. Asset allocation weighed on performance due to the initial overweight to equities, which detracted value during the first stages of the market downturn.

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QUARTERLY COMMENTARY AS OF MARCH 31, 2020

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Conversely, the initial underweight to fixed income had a negative influence. However, the portfolio benefited from the overweight allocation to cash over the quarter. The Canadian and global equity components detracted value mainly because the portfolio's positioning was geared towards a cyclical recovery with a large overweight to the energy sector and underweight to utilities. The fixed income component also underperformed.

The unprecedented economic fallout from COVID-19 and the unexpected decision from OPEC+ members to boost oil production despite falling demand will have a lasting impact on financial markets beyond the current social distancing measures. Consequently, we implemented a much more defensive portfolio posture.

As a result, the portfolio's allocation to cash and fixed income holdings were increased. Not one region is isolated from the significant negative impact resulting from the spread of COVID-19 and as such, we lowered the portfolio's exposure to equities by initiating underweights to both the Canadian and global equities components. Within foreign equities, we reduced our exposure to most regions and trimmed the overweights to developed Asia and emerging markets.

From a sector standpoint, we reduced our exposure to cyclical sectors by significantly trimming our exposure to financials to underweight as the aggressive response of central banks to the crisis creates a challenging macro environment for banks. We also decreased our exposure to energy as the supply and demand imbalance will likely persist for some time. Exposure to defensive sectors was raised across the board, most notably in consumer staples. Another prominent change is our increased exposure to gold equities.

Growing concerns regarding the global economic environment and heightened volatility in financial markets is also reflected in our currency positioning with an increased defensive bias. We added to our Japanese yen position and reduced our exposure to more cyclical currencies such as the Korean won, Brazilian real and Australian dollar. We increased our underweight to the US dollar as the American currency interest rate differential advantage wanes and the expansion of central banks' balance sheets has typically been associated with

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periods of US dollar weakness. Furthermore, we took advantage of weakness in the British pound to raise our exposure.

Our economic outlook calls for a continuation of the economic slump. We are convinced that the portfolio's defensive positioning will offer protection during the expected market decline over the coming months given the progression of the pandemic and the global scale of the social distancing measures

*CIFSC refers to Canadian Investment Funds Standards Committee. The CIFSC has the mandate to standardize the classification of mutual funds in Canada. <http://www.cifsc.org/>.

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