Desjardins Dividend Income Fund

Desjardins Wealth Management Investments

QUARTERLY COMMENTARY AS OF SEPTEMBER 30, 2020

PORTFOLIO MANAGER:
Desjardins Global Asset Management

INCEPTION DATE:
January 1, 1994

CIFSC CATEGORY*:
Canadian Equity Balanced

Tactical asset allocation of the fund had a positive impact on the third quarter's return, adding 0.08%. An overweighting in preferred shares was the main source of added value over the period, while deviations in other asset classes made a slight contribution to the return. Security selection trimmed 0.61%. We maintained a slight underweighting in Quebec equities in the portfolio in anticipation of a deterioration in economic activity due to a resurgence in coronavirus cases. This underweighting was offset by a slight overweighting in preferred shares.

Fixed income market

In Q3 2020, the financial markets saw economic activity gradually regain momentum and unprecedented interventions on the bond market. The 2- to 10-year yield curve steepened by 0.08%, and the Canadian government's 10-year yield ended the quarter at 0.56%, up 0.03% over the period. Against this backdrop, the bond portfolio's performance beat its benchmark in the third quarter, resulting in a total return of 0.56% versus 0.44% for the benchmark. Added value over the period stemmed from positioning the portfolio to take advantage of the steeper yield curve and an overweighting in corporate securities. However, an underweighting in long-term corporate securities detracted from added value. Changes this quarter include the reinvestment of several short-term (1 to 1.5 years) bank securities in the provincial and federal agency sector with 3- to 4-year maturities, at an extremely attractive level historically.

Next quarter, we'll see a return to a neutral position on the yield curve once we reach our intervention targets. In the current climate, we'll continue to buy provincial and corporate securities with long-term maturities if the valuation is justified.

Preferred shares

The preferred share market kept up the momentum begun in the second quarter. The benchmark index posted a return of +11.4% for the period. All structure types ended the quarter with positive returns, but rate-reset preferred shares recorded the best performance.

A new product was introduced on the Canadian bond market in the third quarter: limited recourse capital notes (LRCNs). The Office of the Superintendent of Financial Institutions (OSFI) has accepted the

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Preferred shares (cont'd)

product as a capital instrument, with certain conditions. Not only can this new product serve as a substitute for preferred shares in the AT1 tranche for financial institutions (up to 50%), but given the current market situation, it's clearly less expensive for them to issue this type of instrument than preferred shares. As a result, financial institutions will be turning away from the primary preferred share market for a while. In addition, existing preferred shares will likely be redeemed by issuers in order to substitute them with LRCNs.

This was a key contributor to the growth seen on the preferred share market over the period, particularly in bank and life insurance company securities. It will clearly be a game changer for the preferred share market in the long term.

While a number of factors call for caution as the fourth quarter begins, preferred shares remain an attractive asset class in the medium term. Despite the quarter's growth, the current levels still offer interesting returns, at least compared to many other types of investments. The introduction of LRCNs and their impact on the primary market, as well as the share redemptions by banks and, potentially, insurance companies, should support the market.

The portfolio posted a performance similar to its benchmark over the period.

Canadian stock market

The financial markets continued to advance in the third quarter, and some indexes with heavy exposure to the technology sectors set new records. Thanks to the better-than-expected results, the announcement of new programs to support the economy and the sharp drop in bond yields, investors took greater risks in hopes of achieving higher returns. For the time being, investors don't seem overly worried about the negative impacts of the crisis on this year's corporate results and are paying more attention to positive revisions by analysts and the anticipated improvement in earnings for next year. The S&P 500 was up more than 5% for the 3-month period ending September 30 after advancing more than 20% in the previous quarter. In Canada, the S&P/TSX grew 3.9%. Industrials recorded the index's best performance, climbing 13.2%. The utilities sector also posted solid gains. Renewable energy securities were among the top contributors to the quarter's performance.

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Canadian stock market (cont'd)

Despite the recent decline in market volatility, the outlook for returns is limited given the numerous uncertainties (economic recovery pace, second quarter financial results, China-US relations, bond market interventions and vaccine development). Given the circumstances, we're remaining cautious and keeping a close eye on the situation.

The bond portfolio ended the quarter 86 basis points above the benchmark. The following sectors had a positive impact on the portfolio's performance: utilities (+0.11% compared with the benchmark), consumer discretionary (+0.06%) and information technology (+0.05%). Conversely, the financial services and materials sectors had a negative impact on relative performance (-0.59% and -0.18%, respectively). First, in the financials sector, Canadian Imperial Bank of Commerce (+11.06%) took 24 basis points from the fund's performance due to its underweighting in our portfolio. In second position, Teck Resources Ltd. (+30.74%) brought down the fund's performance by 11 basis points as a result of a lack of shares in the portfolio.

*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/.