FIRST ASSET
EXCHANGE TRADED FUNDS
A CI Financial Company

FIRST ASSET INVESTMENT GRADE BOND ETF
MANAGER COMMENTARY
MAY 18, 2018
TSX: FIG

Income Generation

For the week of May 18, 2018.

A solid retail sales report in the U.S. on Tuesday, which gave rise to confidence in the economic outlook, pushed Government bond yields globally higher. In several markets, namely Canada and the U.S., yields broke important technical barriers. In Canada this was 2.21% in 5 year-, and in the U.S. 3.05% in 10 year-Treasuries. These yields subsequently traded to 2.35% and 3.13% in 5 year Canadian Government Bonds and 10 year Treasuries, respectively, prior to a relief rally at the end of the week. On the week, ten year Government bond yields in our investment universe closed as follows: Canada 2.48% (+10bps), U.S. 3.07% (+10bps), UK 1.50% (+6bps) and Germany 0.58% (+2bps).

Duration of the First Asset Investment Grade Bond ETF (the "Fund") was 1.75 years short relative to its benchmark, the FTSE TMX Canada All Corporate Bond Index, as interest rates sold-off. We subsequently increased duration 0.5 years by reducing our short positions in futures and deploying some cash to buy ten year Canadian Government Bonds. In addition, 5 intra-day trades are initiated, using 30 year UST futures, to generate interest rate alpha. Each of these trades, plus the one carry-over trade from last week, were unwound at a profit.

For those who have followed our commentaries and/or listened to us speak over the last few years, you will recall that we have noted a 3.05% -3.10% yield on U.S. Treasuries, as a critical level on interest rates. We believe this level represents the top of the channel, technically speaking, in terms of the 30 year secular bull trend in interest rates. As noted above, we did briefly break this level this week. Although significant, we want to remind our readers that the 3.05% - 3.10% level needs to be broken and maintained for a full 90 days, to be considered as a break of the secular trend. In the short term, we do expect 10 year U.S. Treasury yields to move higher and potentially test the 3.20% - 3.25% area. Our strategy is to move to a more neutral-duration position, at around 3.15%, and get structurally long in the 3.20% to 3.25% range. In our view, these levels will represent far too much tightening by the Federal Reserve System, relative to the terminal rate. (Terminal rate is the rate that is consistent with full employment and capacity utilization and stable prices.)

Higher Government bond yields have yet to give investment grade corporate bonds a meaningful bid, that translates into credit spread tightening. Although there does appear to be a modest pick-up in foreign demand for U.S. dollar credit over the past few weeks, new issue supply, nominal fund inflows and some duration selling have countered this positive. In addition, a stronger U.S. dollar (which is negative for multi-national company earnings), execution risk for higher leveraged companies (i.e. AT&T, Campbell Soup) and trade friction worries, are keeping credit spreads from tracking tighter.

Credit spreads were nominally wider this week in the U.S. and Europe (1-2 bps), while they were about 1 basis point tighter in Canada. In terms of our Fund, Campbell Soup was a notable underperformer. Credit spreads widened 5-10 basis points following a weak quarterly earnings report. Enbridge Inc. outperformed, as the company announced a corporate simplification plan with respect to its holdings in Spectra Energy and the Enbridge Income Fund.

New issue activity in the Canadian investment grade corporate market this week can be summarized as follows:

- Honda Canada Finance $500mm 3.444% 05/23/2025 +102.2 bps.

The Fund did not participate in this transaction.

Portfolio Transactions

The recent new issue, 2028 Great West Life in U.S. dollars, which was purchased on a duration weighted basis, versus holdings of ten year U.S. Treasuries, was sold at a profit as credit spreads tightened on the new issue.

MARRET ASSET MANAGEMENT INC.

Paul Sandhu
Vice-President and Portfolio Manager
Marret Asset Management Inc.

Paul Sandhu has 29 years of domestic and international fixed income experience. Prior to joining Marret, Paul was responsible for the global distribution of Canadian fixed income and money market products at BMO Capital Markets. Through offices in Toronto, Montreal, Vancouver, New York, London and Hong Kong, Paul was directly responsible for advising the world's largest fixed income asset managers on portfolio strategy, asset mix, security selection and alpha/beta generation.

Paul's career also includes positions with Goldman Sachs and Citibank in Europe, the United States and Canada.

Paul holds a B.A. (Economics and Political Science) from the University of British Columbia and a Masters in Public Administration from the University of Victoria.

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First Asset - **Smart Solutions™**

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