FIRST ASSET INVESTMENT GRADE BOND ETF
MANAGER COMMENTARY
AUGUST 11, 2017
TSX: FIG

For the week ending August 11, 2017.

There is nothing more frustrating as a portfolio manager, than to have your portfolio set up exactly the way you want it fundamentally and technically and then be broadsided. That is sort of how we felt this week, as geopolitical rhetoric between the U.S. and North Korea, caused a significant risk-off/flight-to-quality response in financial markets. The First Asset Investment Grade Bond ETF (the "Fund") portfolio was short duration relative to its benchmark and approximately 75% invested in investment grade corporate bonds. Both were the wrong way to be as Government bonds rallied and credit spreads (which were already fully valued as we noted last week) widened with the sell-off in stocks. We did our best to make the most out of a situation which would result in underperformance relative to the benchmark. The following actions were undertaken:

- We executed 8 trades using U.S. Treasury ten and thirty year futures contracts in order to manage the duration of the Fund. Each of these was unwound at a profit. Given we were short duration in a rallying bond market, these trades offset some of our tracking error relative to the benchmark.
- As credit spreads widened, we did increase credit exposure modestly to take advantage of better valuations longer term, as fundamentals in our view (absent a "hot" conflict between the U.S. and North Korea), are still supportive of corporate credit.
- Our short positions in credit indices (the U.S. Investment Grade Corporate Credit Default Index and the iTraxx Crossover Index) helped to insulate the Fund a bit from the widening in corporate credit spreads. Clearly having larger hedges on would have been valuable. However, increasing these hedges following abrupt moves is not always prudent.

The U.S. and European investment grade corporate credit indices widened 3 and 6 basis points respectively. Cash spreads in these markets were 5-15 basis points wider. Cash spreads underperformed the most in the U.S. specifically due to the recent heavy new issuance in that market. Investment grade corporate credit spreads in Canada, which are typically lower beta, were 2-5 basis points wider.

Although investment grade new issuance in the U.S. market continued unabated with yet another large M&A financing for British American Tobacco (BAT), there were no new issues in the Canadian market this week.

Ten year Government bond yields in Canada and the U.S. declined 7 basis points over the week. In Europe, the comparative move was 9 basis points lower. The week was very light on economic data globally. Today's CPI data in the U.S. was the highlight and it came in slightly weaker than expected (the fifth month in a row). In our view, this supports the Federal Reserve System's cautious approach to hiking interest rates and underscores "lower for longer".

The Fund has been positioned short duration versus the benchmark most of the year. We thought we should explain this view more specifically. To be clear, we are not bearish on interest rates. As noted above, and articulated in our weekly commentaries in the past, we believe the muddle through growth environment combined with muted inflationary pressures will allow central banks to be patient in reducing monetary policy accommodation. In short, we maintain the view that central banks are not tightening monetary policy, they are merely lessening accommodation. However, our duration positioning (which has consistently been augmented by intra-week duration adjustments) is based on the view that the market is somewhat complacent (i.e. pricing in) on the short-term pace of the Federal Reserve System monetary policy tightening. Therefore, we believe it is prudent to be short duration as a core positioning and manage duration actively relative to this core. As Government bond yields move toward the year's lows, both our fundamental view and our technical models, advocate a continued duration reduction posture. Ten year U.S. Treasuries are closing today at 2.19% (2.12% being the 2017 low yield). We see fair value more in the 2.25% to 2.35% area. Therefore being short duration, to us is prudent. Clearly, this hurt us somewhat this week given the rise in geopolitical tensions and the accompanying Government bond rally.

Portfolio Transactions

In addition to the futures trades outlined above, on the widening of credit spreads we increased existing positions in Goldman Sachs 2027, Morgan Stanley 2027 and Johnson and Johnson 2027. These were purchased on a duration neutral basis versus selling existing government bonds. We sold a portion of our position in HSBC Canadian dollar denominated 2022's.

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.

1 (877) 642-1289 | www.firstasset.com | info@firstasset.com

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