FIRST ASSET
A CI Financial Company

FIRST ASSET LONG DURATION FIXED INCOME ETF
MANAGER COMMENTARY
Third Quarter 2017
TSX: FLB

This is the summary of the First Asset Long Duration Fixed Income ETF's (the "Fund") performance in the third quarter, our outlook for the markets and the Fund's positioning.

Looking back – Easy global financial conditions pave the way for uneasy central bankers

Fresh off year-to-date lows in global interest rates and inflation expectations, the meeting of global central bankers in Sintra, Portugal at the end of first half of 2017 instilled renewed confidence in the global cyclical upturn that has been underway since mid-2016. More notably, however, the meeting gave way to a seemingly coordinated hawkish tone from developed market policy makers that caught some investors by surprise in light of still-tepid inflation. Against this backdrop, the second half of 2017 began with U.S. rates moving noticeably lower. By the beginning of September, 10-year U.S. yields made new year-to-date lows close to 2% as months of disappointing economic activity data persuaded the market to price out any further Federal Reserve System ("Fed") hikes. Yet throughout it all, global financial conditions remained incredibly supportive giving way to continued outperformance of risky assets including equities, corporate bond spreads and, on the back of a very weak U.S. dollar year-to-date, emerging market sovereign spreads. This, perhaps above all else, has given the Fed the confidence to continue on its tightening path. As per details it had communicated in June, the Fed announced it would commence its program to normalize the Fed balance sheet in October. While this was largely expected, the famous Fed dot plot revealed that the majority of members deemed that another interest rate hike of 0.25% would be needed before the end of 2017. The subsequent move higher in U.S. interest rates resulted in a round trip (down and up) throughout the quarter.

The Bank of Canada ("BoC"), for its part, took advantage of better than expected economic results, despite slowing inflation (which remains stubbornly below its 2% target) to "undo" the interest rate cuts it gave Canadian economy in 2015 following the commodity crash. Whether it was a desire to remove "unnecessary" stimulus or a fear of financial system instability stemming from highly indebted consumers, the BoC's interest rate hikes throughout the third quarter made it the only central bank post-Sintra to directly increase lending rates. Appropriately, the Canadian fixed income market was the worst G10 performer throughout the third quarter. The consequences of recent tightening actions will only reveal themselves in subsequent months, yet the market expects the BoC to continue to hike at least two more times over the next year. The Bank of England ("BoE") has also changed course recently. In September, it noted that the coming months may see a withdrawal of monetary stimulus "to return inflation sustainably to target." To be clear, however, the bank has stated that much (if not all) of the observed U.K. inflation over the past year has been due to the huge depreciation of the currency following the Brexit vote. That hardly signals a strong, red-hot economy needing to be reined in. As Brexit negotiations continue to loom large, the risks to the U.K. economy and labour market are as grave as ever. Any tightening by the BoE may prove to be short-lived. Meanwhile, despite interpretations of hawkish turns, the Bank of Japan and European Central Bank continue to resist taking action in a post-Sintra world. The lack of meaningful inflationary pressures keeps them sidelined in an otherwise action-packed lineup. Over the third quarter, nominal 10-year interest rates were unchanged in Germany and Japan, while in U.S., U.K. and Canada they increased 0.03%, 0.11% and 0.36%, respectively.

Performance Analysis

The Fund's portfolio fell by 3.83% in the third quarter, while outperforming the FTSE TMX Canada Long-Term All Government Bond Index (the "Benchmark") by 0.40%. The total return outcome of the Fund was primarily driven by the rise in long-term Canadian interest rates, with limited offset coming from the net compression of government credit spreads.

On a Benchmark relative basis, duration and yield curve positioning added the most to the Fund's alpha, benefitting from our underweight duration position in longer maturity Canadian bonds, as this market softened during the period. The outperformance of US duration exposure relative to Canadian duration also supported alpha, as the latter market faced headwinds from two Bank of Canada rate hikes. This relative market shift outweighed the negative impact of residual US dollar exposure on alpha. Foreign currency positioning in the portfolio is actively managed through a hedging overlay. In the spread product sphere, while Canadian government spread exposure subtracted mildly from alpha, overweight positions in emerging market spreads exerted a larger positive influence on alpha, as this sector outperformed relative to its nominal government benchmark bonds.

Looking forward – Risk of monetary policy missteps trumps all political risks

Between North Korean nuclear tensions in Asia, numerous hurricanes, U.S. policy paralysis, NAFTA negotiations, the Italian election, the Catalonian referendum or Brexit negotiations, there has been no shortage of political headlines to grab investors' attentions. Yet the paths of global economic developments and financial markets will continue to be shaped, as they normally are, by central bank policy. Our focus continues to be on analyzing developments in monetary policy and assessing appropriateness given real economic realizations.

Absent a misstep (tightening too much, too quickly) by any one of the major central banks, the cyclical upturn that has been underway for more than twelve months now should continue to persist. Despite less accommodative monetary policy stances from numerous central bankers, the market's assessment of implied interest rate volatility is at the year-to-date lows, meaning that global financial conditions continue to support investors' appetite for risk (in all asset classes.) However, valuations of credit risk premiums are approaching the pre-financial crisis levels of 2007 and, therefore, careful portfolio construction is critical. To weather this challenging environment or protect against a mistake by any one of the major central banks, it is imperative that investors properly balance and diversify their portfolio investment risks.

Positioning – Duration, Curve, and Spreads

The Fund is moderately underweight duration relative to benchmark, primarily concentrated in the 20-year portion of the yield curve. Federal and provincial bonds are utilized to manage much of this yield curve positioning. Within the spread product domain, we are underweight Canadian government agency and municipal debt, and hold positions in US dollar emerging market sovereign debt and inflation-linked bonds.

During the third quarter, we made reductions to our US inflation-linked bond positions, and shifted this exposure back to the Canadian market via purchases of federal debt. In addition, we added moderately to Canadian duration at the long end of the yield curve via purchases of federal and provincial debt.

	1 Month	3 Month	6 Month	YTD	1 Year	SI
First Asset Long Duration Fixed Income ETF	-2.59%	-3.95%	-1.01%	0.25%	-8.13%	-1.97%
FTSE TMX Canada Long Term All Governments Index	-2.66%	-4.24%	-0.38%	1.14%	-7.20%	0.07%

Source: Morningstar Direct as at September 30, 2017

Inception date: May 11, 2016

FTSE TMX Canada Long Term Government Bond Index is designed to track the performance of the long term (over 10 years) government of Canada bonds denominated in Canadian Dollars (CAD).

1The indicated rates of return are the historical annual compounded total returns, including changes in unit value and do not take into account sales, redemption or optional charges or income taxes payable by a security holder that would have reduced returns.

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Signature Global Asset Management

Signature Global Asset Management manages a diverse range of equity, balanced and income funds, and is CI Investments' largest in-house portfolio management group. The team of over 40 investment professionals, led by Chief Investment Officer Eric Bushell, manages over $55 billion and has offices in Toronto and Hong Kong.

Investment Philosophy

The Signature investment philosophy is designed to deliver the best possible risk-adjusted returns in today's complex environment and is based on these key elements:

- The globalization of the world economy has resulted in increased complexity, requiring specialized knowledge.
- The increased interconnectivity of the global economy demands collaboration.

First Asset - **Smart Solutions™**

First Asset, a CI Financial Company, is a Canadian investment firm delivering a comprehensive suite of smart ETF solutions. Rooted in strong fundamentals, First Asset's smart solutions strive to deliver better risk-adjusted returns than the broad market while helping investors achieve their personal financial goals.

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