DWIC Diversified Bond Strategy

First Quarter Commentary – March 31, 2013

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Investor optimism of improving economic growth in North America and fading risks in Europe contributed to a gradual rise in bond yields in January and February. Earlier concerns about political gridlock in the US that would hamper the implementation of deficit reduction strategies and lead to the imposition of automatic fiscal austerity measures were quickly overlooked. Improving investor confidence was evident across many markets, as witnessed by rising equity prices, decreasing corporate bond yield spreads and rising bond yields. Canadian government 10 year bond yields rose above 2.0% for the first time since May 2012.

The optimistic backdrop began to fade by early March. In the US, as well as Europe, a series of weaker economic data began to temper earlier optimism amongst investors. An unexpected and severe banking crisis in Cyprus added to the cautious tone and was a catalyst for a "flight-to-quality" to high quality government bonds of which Canada was a beneficiary. By the end of March, longer-term bonds yields had largely reversed the modest increases of January and February. In Canada, the decline in yields was greater as weakness in the housing sector lowered expectations of the pace of future economic growth.

In Canada, as well as in other developed countries, disappointment with the pace of economic growth sustained a bias towards accommodative, and in some cases, additional monetary stimulus. The Federal Reserve sustained its bond buying program and the Bank of Japan announced an aggressive policy of quantitative easing in a desperate effort to reverse the chronic deflation afflicting the country. While the Bank of Canada has never felt the need to adopt such policies, a subtle shift in policy expectations developed as a result of the downgrade in future growth expectations. Expectations of a possible future rate reduction by the Bank of Canada sometime this year pushed 2 year government yields below 1.0% for the first time since July 2012.

Throughout the quarter we maintained a relatively low portfolio duration given the fundamentally expensive valuations in the government debt market. The duration of the portfolio was raised closer to 4.5 years from 4.0 years when Canadian 10 year yields rose above 2.0% in late January. This move was reversed back to 4.0 years when the yield declined to 1.80% towards the end of March. As corporate bond spreads narrowed, transactions were pursued that improved the overall credit profile of the corporate bond portfolio as well as the disposition of securities that reached valuations that were deemed to be relatively expensive. On the modest US dollar corporate bonds held, the USD hedges were reduced from 100% (which was established around $1.0300) to 90% when the Canadian dollar strengthened to $1.015.

As at March 31, 2013	**3 Month**	**1 Year**	**3 Year**	**Since Inception**
DWIC Diversified Bond Strategy	1.32%	5.00%	6.43%	6.08%
DEX Universe Bond Index	0.69%	4.54%	6.45%	6.12%

Inception date: March 2009

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