DWIC Diversified Bond Strategy

Second Quarter Commentary – June 30, 2013

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Early in the second quarter, bond yields drifted lower in response to weaker economic data and reached their lows for the year in the first week of May. A series of stronger data points reversed this trend pushing yields higher into the range in place during the first quarter. Comments from US Federal Reserve (Fed) Chairman Bernanke regarding the eventual reduction of bond purchases by the Fed was a catalyst for a rise in bond yields to their highest level since July 2011. These comments generated weakness across many asset classes including corporate bonds and equities as investors reacted in anticipation of the change in Fed policy.

The statement by the Fed Chairman regarding the eventual need to begin reducing the $85 billion of monthly bond purchases by the central bank was similar to comments made earlier in the year. Consistent in his message was that the timing will be dependent on confidence that the US is on the path to improved labour market conditions. While the timing of the reduction in Fed bond purchases remains unclear, expectations are that it will begin before the end of the calendar year. The decision to begin to increase the Fed funds rate still remains a distant prospect. Sufficient improvement in labour market conditions is expected to defer this action until late 2015 or possibly early 2016. In Canada, the new Bank of Canada Governor elected to maintain the low overnight borrowing level given the emerging headwinds to Canadian economic activity.

With no change in policy rates, the yield curve of both countries steepened as longer term yields rose. The Canadian 10-year yield reached a high around 2.60% in late June, before drifting lower to 2.44% in the final week of the month. Longer term US yields remained higher than Canadian yields with the US 10-year yield reaching a peak of 2.73%, and ending June at 2.64%. The ensuing market turbulence following Chairman Bernanke's comments caused yield spreads of provincial and corporate bonds to increase relative to federal bonds. The greatest increase occurred in high yield bonds followed by investment grade bonds. Credit spreads began to decline into the end of June as bond yields declined.

During the quarter, the Fund was active in adjusting both its duration and credit exposure. Beginning the quarter with a duration of 4.40 years, the duration was reduced to a low of 3.75 years in early May and gradually increased to 5.50 years as yields rose into early June. The corporate bond weighting was similarly increased as bond yields rose which corresponded to an increase in corporate bond yield spreads. Cash positions that were held in Treasury bills and floating rate notes were invested in Canadian five-year bonds reflecting the improvement in the valuations of short-mid to mid-term yields. In addition, a small investment in real return bonds was made when the breakeven yield (the difference between the nominal and real yield) declined coincident with the rise in nominal yields and credit spreads.

As at June 30, 2013	3 Month	1 Year	3 Year	Since Inception
DWIC Diversified Bond Strategy	-1.93%	0.91%	4.69%	5.24%
DEX Universe Bond Index	-2.36%	-0.17%	4.59%	5.48%

Inception date: March 2009