DWIC Diversified Bond Strategy

Third Quarter Commentary – September 30, 2013

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The trend of rising bond yields continued throughout most of the third quarter, but at a slower pace, propelled by selling pressure from various constituents of fixed income investors. The momentum in the rise in yields appeared to provide a catalyst to bring on more sellers motivated by an extrapolation of the recent trend or forced to divest of unprofitable trades. For reference, the ten year bond yield reached a high of 2.82% in Canada and 3.00% in the U.S. The rise in bond yields increased as the term-to-maturity extended causing the yield curve to steepen. The magnitude of the rise contributed to underpinning a negative view on the return prospects for fixed income going forward.

The material change in bond yields, aided by the dominance of sellers and extreme bearish sentiment towards debt investments masked an absence of a material change in economic or policy conditions. Global and more localized (Canadian and U.S.) economic growth remained modest, inflationary pressures remained muted and unemployment remained elevated supporting the continuation of accommodative monetary policy. Major central banks, including the Federal Reserve and the Bank of Canada, reiterated that accommodative monetary policy conditions were warranted and that policy rates would remain unchanged for a long time.

These factors suggested that the rise in bond yields was excessive given the fairly static fundamental and policy conditions. The peak in bond yields was reached in early September after which yields drifted towards levels existing at the beginning of the quarter. From the expensive valuations that existed in the latter half of 2012 to May 2013 bond yields ended the quarter at levels that were more representative of fair value given the economic and policy environment. During this period corporate bond yield spreads exhibited a moderate amount of volatility but ended the period little changed. The most notable development was the deterioration in liquidity in the corporate bond market largely reflecting the reluctance of investment dealers to warehouse positions and net selling by investors.

During the quarter we continued our strategy of increasing portfolio duration as yields rose. By early September the portfolio duration had been increased near the yield highs to 5.75 years reflecting an incremental increase from 5.50 years at the start of the quarter. The corporate bond weighting decreased marginally during the quarter due to 44% from 46% due to selective net divestitures.

As at September 30, 2013	3 Month	1 Year	3 Year	Since Inception
DWIC Diversified Bond Strategy	0.49%	0.33%	4.05%	5.10%
DEX Universe Bond Index	0.11%	-1.28%	3.55%	5.21%

Inception date: March 2009