



# INCOME STRATEGY THIRD QUARTER REVIEW

## This drama is boring.

Summer has come and gone and we could have put the snooze button on and enjoyed the weather a bit more rather than watch prolonged unnecessary drama. Over the quarter, the markets have moved but not unexpectedly – volatility remained but directionally we knew where interest rates were going.

NAFTA, being one of the main contributors to the volatility as several deadlines came and went, was finally ‘resolved’ in the final hours of the quarter. Thank goodness! Now we can move on. Global trade wars between the US and China are still outstanding but with NAFTA being another “win” for Trump, I’m sure his focus will be trying to get the next win (which will mean more volatility until then).

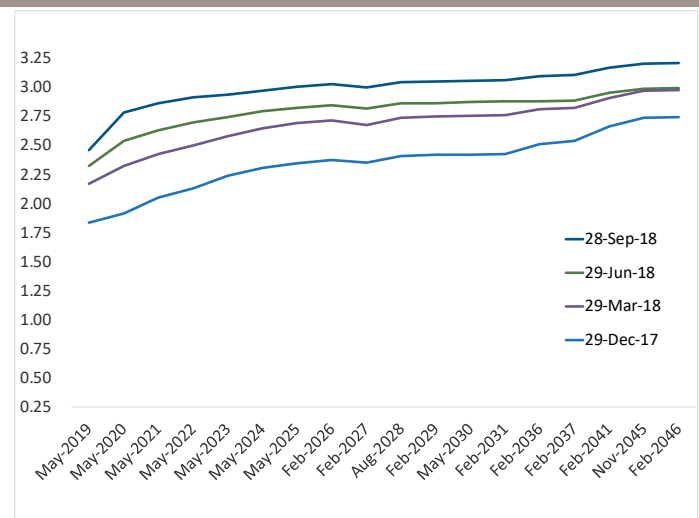
What has not changed: there has continued to be a string of solid economic data out of both the US and Canada to keep both their respective central banks on track to the anticipated interest rate increases for the year.

### Quarterly Review

During the quarter, the US increased its overnight interest rate by another 25bps to a lower bound of 2% in its September meeting (its third interest rate increase in 2018). Meanwhile, Canada increased interest rates by another 25bps in its July meeting taking its overnight interest rate to 1.50% (its second interest rate increase in 2018). We anticipate one more interest rate increase for both the US and Canada.

The US yield curve shifted upwards and yields increased anywhere between 14bps to 24bps across the curve. The 2-year to 30-year curve flattened by 3bps.

Exhibit 1: U.S. Yield Curve



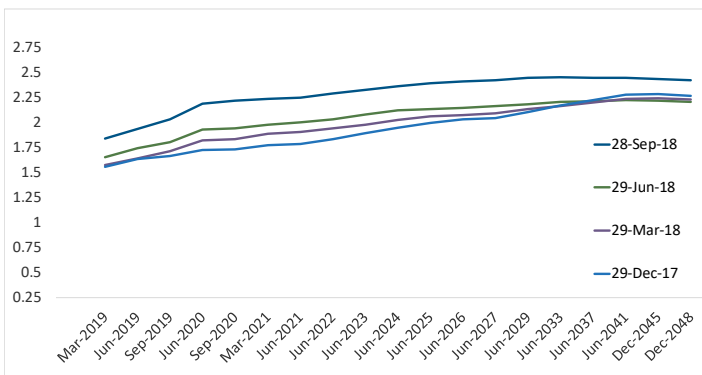
Source: Bloomberg

During the quarter there was volatility, but through the “noise” of concerns with trades and other global fears, investors realized that the US economy is performing well and interest rates would continue to rise.

The Canada yield curve shifted upwards and yields increased anywhere between 18bps to 26bps across the curve. The 2-year to 30-year curve flattened by 6bps.



**Exhibit 2: Canada Yield Curve**



Source: Bloomberg

While the upward shift in the yield curve is not surprising (considering both Canada and the US increased interest rates during the quarter), the flattening might be a bit more perplexing or concerning to those who might think that is signaling a recession. What we should note is that the 30-year government bonds in both the US and Canada are in demand globally because they are inexpensive vs. the rest of the world: both the US and Canada are AAA rated and yield 3.2% and 2.4%, respectively, vs. other AAA rating countries that yield sub 2%.

Canadian investment grade corporate spreads decreased between 1bp to 4bps, driven by strong economic and corporate performance, as well as general heightened demand for corporate spread product (since corporate spreads help to cushion the capital depreciation during a rising interest rate environment) and disappointing new issue supply for Q3 of \$24bln (flat to Q3/17).

Returns for various fixed income asset classes are in the table on the next page. While corporate bonds performed better than government bonds, the spread compression (ie. decrease of yields) of the corporate bonds was not enough to offset the move in the underlying government bond as both asset classes saw negative returns. In Q3/18, our transition into more corporate bonds and shortening of the duration in the Fund helped with the outperformance vs. our benchmark.

**Exhibit 3: Sovereign Rates**

Country	Currency	Maturity	Coupon	Price	Yield (%)	Avg Rating
UNITED STATES	USD	8/15/2048	3	96.046875	3.21	AAA
CANADA	CAD	12/1/2048	2.75	107.405	2.40	AAA
FRANCE	EUR	5/25/2048	2	108.05	1.65	AAA
GERMANY	EUR	8/15/2048	1.25	104.483	1.07	AAA
SOUTH KOREA	USD	9/20/2048	3.875	100.375	3.85	AA-
BRITAIN	GBP	12/7/2049	4.25	155.264	1.89	AA-
SPAIN	EUR	10/31/2048	2.7	102.645	2.57	A
JAPAN	JPY	6/20/2048	0.7	95.355	0.88	A
MEXICO	USD	2/10/2048	4.6	94.324	4.97	BBB+
COLOMBIA	COP	6/16/2049	3.75	97.851	3.87	BBB
ITALY	EUR	3/1/2047	2.7	85.614	3.53	BBB
PORTUGAL	EUR	2/15/2045	4.1	121.591	2.91	BBB-
NETHERLANDS	EUR	1/15/2047	2.75	140.475	1.08	BBB-
BRAZIL	USD	2/21/2047	5.625	89	6.48	BB-
SWITZERLAND	CHF	1/6/2049	4	195.523	0.56	BB-

Source: Bloomberg, As at September 28, 2018



Asset Class Returns	Q3/18	Q2/18	Q1/18	2017
Bond Universe Index	-0.96%	0.51%	0.10%	2.52%
Corporate Bond Index	-0.46%	0.42%	0.28%	3.38%
FTSE High Yield Canadian Index	1.04%	0.57%	0.91%	9.94%
S&P/TSX Preferred Index	1.54%	0.47%	-0.40%	13.44%

We are still looking at fine tuning our corporate holdings to be better positioned over the next 12 to 18 months. We continue to look for value within corporate bonds (investment grade and high yield) and preferred shares and continue to be selective on issuers, maturity timeframe, and valuation within each individual issuer's capital structure.

I look forward to seeing you at the next client quarterly event in November or otherwise.

### Outlook and Positioning

Since our last quarter's update, we have continued with our transition in the Fund and have fully eliminated our weighting in government bonds, and increased our exposure to corporate bonds. As a result, we have shortened duration from the 4.6 years at the end of Q2 to 3.6 years at the end of Q3.

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#### Asset Allocation

Asset Class	Q3/18	Q2/18	Q1/18
Cash and Cash Equivalents	1%	1%	1%
Government Bonds	0%	4%	17%
Provincial Bonds	0%	5%	18%
Investment Grade Bonds	90%	82%	58%
High Yield	5%	4%	2%
Preferred Shares	4%	4%	4%
	100%	100%	100%

#### Duration (years)

	Q3/18
Cumberland Income Fund	3.6
FTSE TMX Canada Universe	7.4

#### Yield<sup>1</sup> Comparison as at September 28, 2018

	Q3/18	Q2/18
Cumberland Income Fund	3.44%	3.54%
FTSE TMX Canada Universe	2.92%	2.67%

#### Performance<sup>2</sup>

September 28, 2018	Q3/18	YTD	1 YR
Cumberland Income Fund	0.16%	0.26%	2.12%
FTSE TMX Canada Universe	-0.96%	-0.35%	1.66%
Difference	1.12%	0.61%	0.46%

1. Yield is the yield to maturity for bonds and current dividend yield for equities and preferred shares. Yield does not represent the total return of the Fund or the indices shown in the above table.

2. Gross of Fees. Past performance does not guarantee future results.

Cumberland Private Wealth Management Inc. is a leading independent investment firm that provides discretionary investment management and wealth management services for high net worth individuals, their families and foundations, with \$1 million or more in investable assets. All of Cumberland's investment mandates are centered on building and preserving our clients' financial wealth. Founded in 1997, the firm is privately-owned by its employees and headquartered in Toronto, Canada.