

Morningstar Balanced Portfolio

Fund Commentary

After a volatile end to 2018, global markets, as measured by the MSCI World Index, rebounded strongly in the first quarter, rising over 10%. In Canada, the S&P/TSX Capped Composite index outperformed many global markets, returning 13.3% over the quarter. The Bank of Canada maintained interest rates during the quarter, citing concern about growth as well as high domestic consumer debt.

U.S. equities rebounded as well, with the S&P 500 rising over 11% in local currency terms in the first three months of the year. Similar to the Bank of Canada, the Federal Reserve maintained interest rates, while also declaring that there would be no hikes in 2019. This represents a shift to a more accommodative policy despite some political pressure to revert to an easing one from the White House.

Foreign equities, as measured by the MSCI EAFE Index, underperformed the U.S. and Canadian markets, and European leadership seems entirely frozen by the gridlock surrounding Brexit as the clock ticks down on whether a deal can be agreed upon prior to the EU elections. Emerging Markets bounced back after a dramatic decline over the second half of 2018, but still underperformed the MSCI World Index.

We don't intend to always highlight short-term outperformance from our managers as things can change quite quickly, but thought it is worth mentioning the Invesco Emerging Markets mandate, which struggled performance-wise over 2018. The Fund has rebounded admirably to start 2019, rising 17.5% over the first three months of the year, dramatically outperforming the benchmark. While we never expect to get such instant rewards for patience, it's nice to be able to highlight the odd occasion when it does come to fruition.

The continued defensive positioning of our portfolios in the program is founded on our belief that developed equity markets are generally trading at lofty valuations, particularly the U.S. market. Emerging Markets remain attractive, but also come with

added volatility, as the last 15 months have demonstrated. Our response has been to overweight fixed income instruments, particularly short-term bonds and cash.

Over the short term, the market will often respond to the headlines of the day, whether they be political developments or company-specific, in ways that may not be optimal given our positioning. We do not view these with concern. Instead, these present opportunities for us to implement our views at attractive prices and should excite our investors as much as they do our investment team. Over the long term, we remain convinced that valuations are the long-term drivers of returns within and across asset classes, and should benefit our partners and investors in the program with long-term outperformance.

The Morningstar Balanced Portfolio underperformed its benchmark¹ during the quarter.

Positive Contributors

In domestic fixed-income, manager selection added value as both TD Canadian Bond and Leith Wheeler Core Bond outperformed the FTSE Canada Universe Bond Index.

In global bonds, our underweight to the asset class added value over the quarter as domestic bonds outperformed, as did manager selection as the PIMCO Monthly Income mandate outperformed the FTSE WGBI Index.

Our overweight to Emerging Markets benefited the portfolio as Invesco Emerging Markets outperformed the MSCI EM Index by almost 10%. Our out-of-benchmark allocation to North American Energy Infrastructure via the Global X MLP & Infrastructure ETF also contributed to returns, outperforming the MSCI World Index by over 9%. Finally, our out-of-benchmark allocation to the U.K. market via the MSCI UK ETF benefited the portfolio as the region outperformed the MSCI EAFE Index.

In foreign equities, manager selection added value as Capital Group's Global Equity mandate outperformed the MSCI ACWI-ex

¹The Morningstar Balanced Portfolio's benchmark comprises 30% FTSE TMX Canada Universe Bond Index, 8% FTSE World Government Bond Index in Canadian dollars, 18% S&P/TSX Composite Index, 42% MSCI

All Country World Index ex Canada IMI Index in Canadian dollars and 2% FTSE TMX 91 Day T-Bill Index.

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Canada Index, and CI Black Creek International outperformed the MSCI EAFE Index.

Performance Detractors

Overall, the Fund's positioning of being underweight equities in favour of cash and fixed-income detracted from returns over the quarter. Within fixed-income, core bonds outperformed short-term bonds and cash which detracted from relative returns.

In domestic equities, from an asset allocation perspective, the underweight to domestic stocks also hurt the portfolio as they outperformed the global equity market. Additionally, none of the active managers were able to keep pace with the S&P/TSX, which ran hot to start the year driven largely by a health care sector that was up 50% and contains a lot of marijuana stocks. These stocks, for a variety of reasons, do not meet the quality criteria that our active managers will not compromise on.

Oakmark International underperformed the MSCI EAFE Index during the quarter while Invesco Global Endeavour mandate underperformed the MSCI World Index.

We continue to invest with a long-term time horizon, with an emphasis on valuations. We remain confident in the managers and ETFs selected for the portfolio and believe that over the long haul they can add value for investors in the program.

Valuation-Driven Asset Allocation Positioning:

- Maintained specific sector exposure within U.S. equities (Consumer Staples, Health Care, North American energy & infrastructure exposure)
- Maintained lower equity exposure in favour of slightly higher cash and short-term bonds
- Targeting a 1-year duration underweight for domestic fixed-income
- Exposure to Real Return Bonds in Canada
- Maintained lower weight in Canadian equities and U.S. equities and overweight in international, U.K. and emerging market equities

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