Signature fixed income 2017 year-end review: Beware the drunkards

By Alexandra Florescu | January 3, 2018

“Some use statistics as drunkards use lamp-posts – for support rather than illumination.”

As 2017 comes to an end, it is only appropriate that we reflect on positioning and performance across our fixed income strategies and set the course for what is shaping up to be a challenging 2018. That is not to say that 2017 was not challenging. In fact, when we compare “consensus” expectations for 2017 with actual realizations, we see that this past year has been anything but predictable (see Figure 1 below). Not that this should surprise us – as the common saying goes: “Fool me once, shame on you. Fool me twice, shame on me.” If the last several decades have taught us anything, it is that investors’ predictions (in aggregate) have almost always been wrong. When the Fed was in tightening mode, investors persistently predicted fewer hikes than the Fed delivered, and the rest of the time, interest rates were supposed to shoot for the moon, but ended up six feet under. When in doubt, blame gravity.

Figure 1: Consensus expectations versus outcomes for 2017

Consensus expectations for 2017	Realizations throughout 2017
US 10-year interest rates would be roughly 3% by the end of 2017	US 10-year interest rates are sub 2.4% today (i.e. they are lower than they were at the start of 2017)
US wage growth would pick up and inflation would exceed expectations	US inflation has missed survey expectations 7 out of 11 months (so far) this year and market's inflation expectations are lower today than at the start of 2017
USD would outperform a trade-weighted basket of developed market currencies	USD has been the worst performer among all G10 currencies (EUR was the best performer)

Source: Signature Global Asset Management

“To guess is cheap, but to guess wrongly is expensive.”

Signature’s approach to managing its fixed income strategies leaves nothing to pundit prognostications. We adopt a carefully designed framework that enables us to diversify our strategies’ exposures across the fixed-income risk spectrum and improve their risk-reward profiles over the long run. In October, Kamyar laid out Signature’s framework for fixed-income portfolio management in his blog “Portable beta in modern fixed income design.” The four pillars of design are summarized in Figure 2 below.

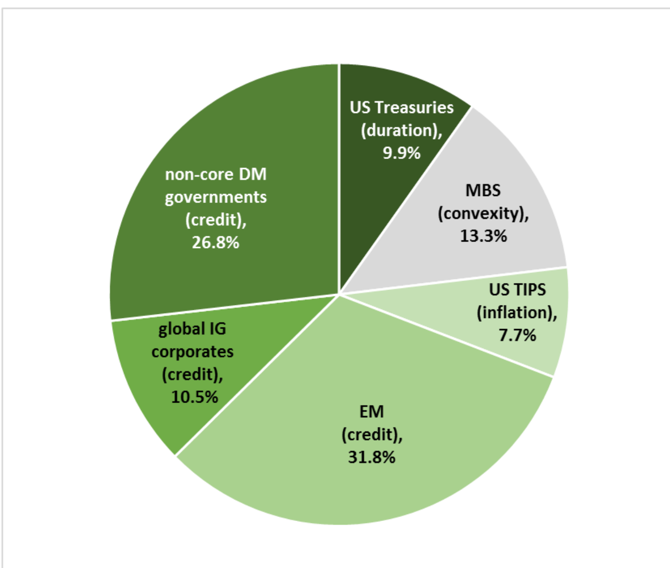
Figure 2: Four pillars of modern fixed income portfolio design

Pillar	Description
Benchmark Replication	Use stratified sampling to efficiently replicate the set of risk factors that dominate the target fixed income market (i.e. benchmark.)
Core Total Return	Identify and manage the dominant fixed income risk to the strategy's absolute return to enhance the strategy's Sharpe ratio.
Core Portable Beta	Construct a long-run, positive carry collection of diversified fixed income risk premia that does not correlate positively to equities.
Portable Alpha	Identify and capture opportunities from a collection of short-term, relative value strategies to enhance the strategy's excess returns.

Source: Signature Global Asset Management

The core portable beta pillar is benchmark-agnostic and, therefore, implemented similarly across Signature's fixed income mandates. Figure 3 below shows the current composition of the core portable beta strategy in the Signature Global Bond Fund. As previously discussed above, it is designed to be a well-diversified collection of fixed-income risk premia (duration, convexity, inflation, and credit) that contributes positively to strategy performance without correlating positively to equity risk premia.

Figure 3: Signature Global Bond Fund core portable beta composition, as of December 12, 2017



Source: Signature Global Asset Management

As for the core total return pillar, its implementation will depend on the dominant risk in each strategy. Figure 4 shows the implementation of core total return for three Signature funds. The goal of core total return positioning is to ensure that each strategy's total risk is lower than that of its benchmark, without compromising portfolio carry.

Figure 4: Core total return strategy implementation

Strategy Name	Benchmark	Dominant Risk	Strategy Total Risk	Benchmark Total Risk
Signature Canadian Bond Fund	FTSE/TMX Canada Universe + Maple Bond Index	Duration	3.2%	3.5%
Signature Global Bond Fund	JP Morgan Global Government Bond Index - currency unhedged	Currency	6.5%	8.3%
Signature Tactical Bond Pool	FTSE/TMX Canada Universe Bond Index	Duration	3.1%	3.5%

Source: Signature Global Asset Management

"Those who have knowledge, don't predict."

Looking back over the past year, the core portable beta positioning contributed positively to all of Signature's duration-sensitive fixed income strategies. Referring to Figure 5 below, which shows the year-to-date performance attribution breakdown for the Signature Global Bond Fund to the end of November 2017, we see that the total excess returns (made up of the core portable beta positions described in Figure 3) contributed positively to alpha performance. On the other hand, returns associated with core total return positions (described in Figure 4) were mixed in 2017. For the Signature Canadian Bond Fund and the Signature Tactical Bond Pool, the flattening of the Canadian interest rate curve detracted from alpha returns in 2017. This happened as short-term interest rates rose with BoC policy action, but long-term (30-year) interest rates fell. For the Signature Global Bond Fund, the euro underweight detracted from performance as the currency was the best performer among its developed market peers, including against the Canadian dollar (CAD).

As we turn our attention to 2018, we maintain the core total return positioning described in Figure 4. As for the core portable beta positioning, we continue to maintain a diversified exposure to fixed-income risk premia by coupling duration-sensitive government bonds with global investment-grade credit, US-dollar-denominated emerging market sovereigns, inflation-linked bonds, US agency mortgage-backed securities and, where appropriate, global high-yield credit and preferred shares. The composition (i.e. the relative allocations between the various assets) will continue to be managed tactically. This is especially important because throughout 2017, some of the asset classes, particularly US IG corporates, outperformed on a risk-adjusted basis and look fully valued.

Figure 5: Signature Global Bond Fund year-to-date performance attribution, as of November 30, 2017, gross of fees, taxes and expenses

	Signature Global Bond Fund	JP Morgan Global Government Bond Index - currency unhedged	Difference
Local return	**2.88**	**1.34**	**1.54**
Components of local return:			
Curve & Duration	**0.75**	**0.24**	**0.51**
Total Excess	**2.13**	**1.10**	**1.03**
Federals	0.14	0.64	(0.50)
Gov't Credit	0.83	0.46	0.37
Mortgages & Securitized	0.12	-	0.12
Inflation-Linked	(0.05)	-	(0.05)
Emerging Markets	0.74	-	0.74
Corporates	0.36	-	0.36
Preferred Shares	-	-	-
Currency return*	**(0.61)**	**1.06**	**(1.66)**
FX overlay	**-**	**-**	**-**
Total	**2.27**	**2.40**	**(0.12)**

**London 4PM FX, where applicable*

Source: Bloomberg, Signature Global Asset Management
Class F returns net of fees are disclosed below.

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Appendix

Figure 6: Signature's duration-sensitive fixed income product suite

Signature's duration-sensitive products are designed to correlate negatively to stocks

Strategy Attributes

Strategy	Canadian Fixed Income		Global Fixed Income	Flexible Fixed Income	Exchange Traded Funds
Name	**Signature Short - Term Bond Fund**	**Signature Canadian Bond Fund**	**Signature Global Bond Fund**	**Signature Tactical Bond Pool**	**First Asset Long Duration ETF***
Benchmark	FTSE/TMX Canada Short-Term Bond Total Return Index	FTSE/TMX Canada Universe + Maple Bond Index	JP Morgan Global Government Bond Index - currency unhedged	FTSE/TMX Canada Universe Bond Index	FTSE/TMX Long-Term All Government Bond Index
Description	Low Duration Fixed Income	Traditional Canadian Fixed Income	Global Bonds and Currencies	Global Diversified Bonds	Deflation Hedge
Foreign Currencies	Hedged	Hedged	Unhedged	Hedged	Hedged
Benchmark Duration	2.8 years	7.2 years	7.6 years	7.2 years	15.2 years
Duration Range	0-5 years	5-9 years	5-9 years	5-9 years	>15 years
Alpha Target (bp)	25-50	50-75	125-175	125-175	25-50
Tracking Error Target (bp)	50-100	75-150	150-250	150-250	50-75

Strategy Attributes

Signature's duration-sensitive products are designed to correlate negatively to stocks

Source: Bloomberg, Signature Global Asset Management
As of December 12, 2017
* First Asset Long Duration Fixed Income ETF is an exchange-traded fund managed by First Asset Investment Management Inc. Signature Global Asset Management, a division of CI Investments Inc., acts as portfolio advisor.

Figure 7: Standard performance data as of November 30, 2017

	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception	
Group/ Investment	Return (Cumulative)	Return (Cumulative)	Return (Annualized)	Return (Annualized)	Return (Annualized)	Inception Date	Return (Annualized)
JP Morgan Global Government Bond Index (CAD)	2.48	1.55	5.90	5.42	5.55	12/29/1989	6.15
Signature Global Bond Class F	1.06	0.18	4.82	4.44	5.61	7/17/2000	3.77
Signature Tactical Bond Pool Class F	2.02	1.99	-	-	-	12/17/2015	2.11
Signature Canadian Bond Class F	1.60	1.10	1.96	2.40	3.96	7/17/2000	4.50
Signature Short-Term Bond Class F	0.37	0.31	0.82	1.13	2.10	11/17/2000	3.00
First Asset Long Duration Fixed Income ETF	5.20	3.91	-	-	-	5/11/2016	1.33