Monetary stimulus takes hold

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Signature GLOBAL ADVISORS

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Investors appear to be finally ready to accept global policymakers' incentives to invest in equities after years of avoiding risk, Eric Bushell, Signature Global Advisors Chief Investment Officer told digital roadshow audiences.

Central banks have used of a deluge of liquidity, underpinned by negative real interest rates, to boost asset values and to keep financial markets calm. That intervention is finally driving a strong recovery in risk appetites, as can be seen with the Chicago Board Options Exchange Market Volatility Index (VIX), which shows the market's expectation of volatility has declined significantly in the past 16 months (see Chart 1).

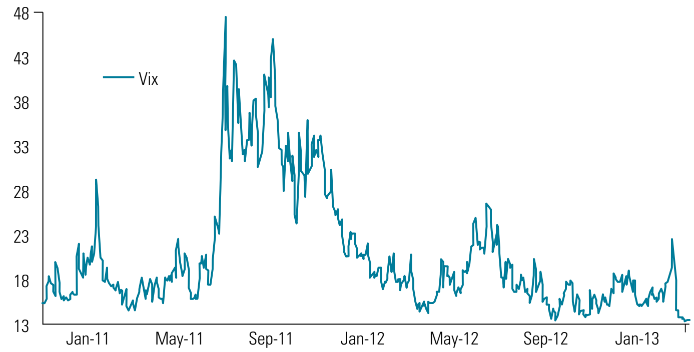
"We expect that in 2013, the financial economy is going to respond to some of these (monetary policy) incentives," Eric said. "We see market upsides coming through."

Asset bubbles forming

One of the consequences of the unprecedented monetary stimulus, however, is asset bubbles, Eric said. The first bubble is occurring in yield-oriented securities such as corporate bonds, real estate and infrastructure, as negative real interest rates force governments, pensions and retail investors take on more risk to get more yield. High-yield bonds, for example, were yielding between 6% and 6.25% in the fall; now they yield about 5.4%.

"Bubble number two is really about capital flows into developing economies," Eric said. "When you have negative real interest rates in the developed markets, you're pushing capital away from those geographies as investors seek higher returns."

Chart 1 – Risk Appetite Recovers



Source: Credit Suisse First Boston

Capital flows to emerging markets stopped in 2011-2012 when the European debt crisis suppressed risk appetites and growth slowed in developing economies. They have now strongly recovered. "There is a risk that these capital flows could reverse abruptly if interest rates begin to rise," Eric said. "In addition, many Asian countries are later in their asset expansion cycle, so there is less opportunity for investors to profit. The runway is shorter this time before inflationary pressures or asset prices stop out the rally."

Signature portfolio positioning

Signature believes 2013 is the year to continue rotating out of government bonds and investment-grade debt. The team expects to reduce the bond portfolio in Signature Canadian Balanced Fund, for example, from its current 30% to about 25% over the course of the year.

The emerging market capital flow story should help to support commodity prices, particularly iron ore and coking coal that are used in the production of steel, copper, and oil, said Portfolio Manager Scott Vali. The price differential between light and heavy crude oil is likely to narrow later in 2013 as new refining systems become operational, and again in 2014 as new pipelines allow for greater movement of heavy crude. Companies that have downstream operations, such as Suncor, will be the greatest beneficiaries.

However, emerging market equity represents the best total return opportunity, Signature believes.

"Emerging market economic indicators look quite positive, especially out of the major BRIC markets," said Portfolio Manager Matt Strauss. "The only exception is Russia, where we see slower, but still decent growth of around 3%. But in terms of investor sentiment, China's economy is most important, and the data is encouraging, clearly indicating a decent growth recovery towards 8%. We won't see the same double-digit recovery that we saw in 2009-2010, but its enough to take care of fears of a hard landing in China."

Dividend yields are compelling, and Signature expects to see a rotation from fixed-income securities into global dividend stocks. CI recently launched Signature Global Dividend Fund, a mandate aimed at investors seeking inflation protection and dividend support in global equities outside of Canada, where valuations are still reasonable.

"We still like the dividend yield and quality story in the intermediate term," Eric said. "It will be important to remain tactical, as liquidity is still not great. We are also not convinced of the European recovery story. But the funds are fully invested and skewed to equity as we see a ray of light coming through."

Class A returns as of January 31, 2013:

Signature Income & Growth Fund

	1 yr	3 yr	5 yr	10 yr	Since inception (Nov/00)
Return	9.3%	7.2%	4.6%	7.7%	6.8%

Signature Diversified Yield Fund

	YTD	6 mo	1 yr	3 yr	Since inception (Nov/09)
Return	2.0%	6.4%	11.6%	7.9%	7.3%

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