Fund Commentary
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Signature High Yield Bond II Fund

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Within any asset class, there are tactical and strategic reasons for investing. Shorter-term tactical reasons tend to be a function of valuation and the expectation of near-term mean reversion. Longer-term strategic rationale generally relate to expected absolute returns, relative returns, volatility and historical correlations (i.e. a diversification benefit). While there is a tactical argument for investing in high-yield bonds at this juncture, we have always emphasized the strategic reasons to invest in the asset class.

While we hope for long-term, strategic investors in our funds who appreciate the high-yield bond value propositions and diversification benefits, we also want to show how we strive to add value and minimize downside in the asset class. As a result, this update will touch less on the macroeconomic environment and current valuations and more on some of the specific bond picks we think will add value to Signature High Yield Bond II Fund and the high-yield component of Signature's diversified income funds.

The U.S. Federal Reserve is now on the cusp of "lift-off" – set to raise overnight rates for the first time in six years. Despite this being incredibly well-telegraphed, with the Fed looking to err on the side of caution, bond investors appear nervous. Government bond yields have backed up since early January's lows and large parts of the fixed-income market have negative year-to-date returns. High-yield bond spreads, which had widened about 200 basis points from June 2014 to December 2014 as part of the global deflation scare, now stand at about 470 basis points for a 6.3% yield, meaning they have recouped only about half of last year's move. To our mind, high yield is trading at fair value in an environment in which the U.S. economy is gradually improving, albeit to a low level, and corporate credit quality is stable. This could suggest there is a tactical trading opportunity in the high-yield bond market. Below you will find four examples that illustrate our different investment approach and reasons for investing in Signature High Yield Bond II Fund. At the core of our process is rigorous, deep due diligence and risk management, with macroeconomic and currency hedging overlays. We marry that discipline with a high-quality bias and focus on loss avoidance. This results in a portfolio that is benchmark agnostic, as evidenced by our 89% active share (84% for Signature Corporate Bond Fund).

Reason to own this fund – a high-quality bias.
Example: Endeavor Energy Resources B3/B- rated 8.125% bonds due 2023 and 7% bonds, due 2021.

Endeavor holds a very large acreage position in the prolific Permian Basin in west Texas. This inventory includes multiple formations stacked vertically, supportive of multiple wells. Endeavor has farmed out 32,000 net acres to Exxon Mobil, which carries Endeavor's share of well development spending. The net asset value of proven developed production reserves, on a conservative basis using a US$65 WTI oil price, covers the company's total debt of $1.5 billion about 1.8 times. Current transaction values of $20,000/acre value the company's total assets at close to $9 billion.

It may be counter-intuitive to use a B- rated bond in an unloved sector to demonstrate our high-quality philosophy. Our high-yield strategy focuses on quality franchises with defensible market share, low cost structures and strong asset values. At times, however, this does not translate into a high (i.e. BB) rating. Nonetheless, in an asset class with asymmetrical returns, focusing on loss avoidance is much more important than reaching for upside. Historical data bear this out, as higher-quality BB-rated bonds tend to outperform on a volatility-adjusted basis, and we consider that to be a tailwind to fund performance. Put another way, we do not mind giving up incremental yield to take risk and volatility out of the portfolios. Endeavor checks these boxes, with phenomenal low-cost assets and a natural acquirer in Exxon Mobil. During the recent Signature Roadshow we discussed the impact of the energy sell-off on the broader high-yield bond market. We were active buyers in the energy sector at the end of 2014, but find ourselves taking profits in 2015 as yields have fallen and energy sector is the best performing sector year-to-date. We will continue to hold companies like Endeavor, MEG Energy and Seven Generations that meet our high-quality criteria.

Reason to own this fund – collaboration.
Example: UBS BB-rated 7% tier 1 fixed-floater perpetual preferred shares.

Tier 1 hybrid instruments of select European banks offer attractive yield with moderate risk, especially in core countries with strong regulators, and Swiss banks have always been required to hold higher levels of capital than their European peers. Additionally, Swiss banks must hold a capital buffer of two types of tier 1 contingent convertible instruments – a higher 7% trigger instrument and a lower 5.125% trigger instrument. Each would convert to common equity if the bank's common equity tier 1 ratio were to breach the respective trigger. We think the lower trigger instruments are well insulated from a capital perspective, as a breach of the higher trigger instruments would invoke a capital plan before the lower instruments would trigger. In addition, under the Swiss regime, tier 1 hybrids include a dividend stopper, which allows the common equity dividend to be suspended before coupons on the hybrids are restricted. We have been adding the low-trigger UBS 7% fixed-floater perpetual preferred shares partially due to the preceding structural reasons, but also due to the relative credit strength of the bank. UBS was one of the first European banks to reduce risk by reshaping its business model away from investment banking and towards wealth management and private banking. Its reported capital ratios are now among the highest in its peer group.

The subordinated and preferred shares of financials have been a high-conviction trade for Signature's high-yield and investment-grade bond teams for some time. The analytics and regulatory legwork that led to this level of conviction is a result of the collaboration between the Signature equity, investment-grade and high-yield sector specialists – the Signature model in action. These positions also check the "high-quality bias" box as yields are comparable to the broader high-yield market, with one notch higher credit quality on average. Adjusting for the new regulatory environment and improving leverage and business models, we believe the default risk of these securities is dramatically over-estimated, and the "extension risk" – the risk that these preferred shares are not called but instead are left outstanding to pay the coupon on a floating basis – can be mitigated by buying fixed-floater preferreds with a high "back-end" floating spread. The back-end spread of the UBS 7% preferreds is high at +487 basis points. This class of securities makes up about 23% of Signature High Yield Bond II Fund and about 19% of Signature Corporate Bond Fund.

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Reason to own this fund – mandate flexibility.
Example: Formula One Caa2/CCC+ rated 2nd lien term loan B LIBOR+675 basis points with a 100 basis-point LIBOR floor, due 2022.

Formula One is the pre-eminent global car racing series, the world's most widely watched annual global sporting competition with 19 Grand Prix events each year. The company has a high degree of revenue visibility in that the broadcast rights are contracted years in advance and the fees each city must pay to host a Formula One event are substantial and non-negotiable (a ready roster of alternate locations is available). The sports' global following makes it an obvious choice for broadcasters who see the content as scarce and valuable, while commercial partners see value in associating with the luxury positioning of the Formula One brand. All of this, combined with the high margins and low capital intensity of the business, make this an attractive investment. We feel comfortable with the equity "cushion" (i.e. the valuation difference in terms of cash flow between the company's debt and equity), when compared to the valuation of sporting franchises such as the Los Angeles Clippers and Manchester United, where the difference is smaller.

With $550 million in loan assets, Signature Global Asset Management may manage more loans than any other non-bank entity in Canada. We have the flexibility to hold loans in lieu of bonds, and currently the loan weight in Signature High Yield Bond II Fund is 12.5%. The analysis of loans and bonds is essentially the same, but generally we prefer the (unsecured) high-yield bond market over the (secured) leveraged loan market for the enhanced yield, better liquidity and upside potential. Loans are generally callable almost immediately after issuance at par or 101, while bonds tend to include three to four years of call protection and call prices that are a couple of basis points above par. Ergo, to remain involved in a loan with an improving credit profile, or in a bull market, is difficult as the loan will be called away shortly after investing, limiting upside and income. Our involvement is driven less by the defensive floating nature of loans and more by our relative value screens and relationships that point us in the direction of interesting, ad hoc, opportunities. We have the flexibility to own bonds, loans, preferreds, private placements, convertible bonds to build the most efficient portfolio we can for our clients.

Reason to own this fund – bench strength and scale, the largest high-yield team in Canada.
Example: Intarcia 6% convertible bond.

Intarcia has developed an implantable drug/device combination for Type 2 diabetes treatment that is effective and pioneering. While the device is only the size of a matchstick, it contains enough diabetes medication for an entire year. Given that less than 20% of diabetes sufferers take their medication as directed, this drug is likely to be widely adopted by insurers, employers and physicians to enhance quality of life for diabetes sufferers and to save costs related to the complications of uncontrolled diabetes. The bond itself is also innovative, as it is secured debt with a 6% interest rate for the first two years. When the company achieves commerciality, payments will be tied to a royalty stream on global sales and the bond is convertible at our option into equity, at what we view as an attractive valuation.

The Intarcia bond was issued on a "private placement" basis, meaning it was not widely syndicated. This is one of the advantages of the Signature team – our scale opens doors for us to unique opportunities unavailable to other managers. This scale is a function of the sector-specialist model within the high-yield bond team, while the size of our portfolio makes us a relevant counterparty to underwriters and borrowers. While we have typically exercised

this strength to structure and price deals in the Canadian dollar market, the Intarcia financing was issued in the U.S. market in U.S. dollars. We have done a number of pharmaceutical securitization financings with U.S. banks over the past decade and our involvement in that space led the underwriters of this deal to us. However, as this is a private placement, the bonds would be difficult to trade if results disappointed or we needed liquidity in the fund. We very carefully manage portfolio liquidity and account for both credit and liquidity risk, keeping the percentage of illiquid securities in the fund(s) to manageable levels.

Signature High Yield Bond II Fund Codes	Class A			Class F	PIM	
	ISC	DSC	LL		Class E	Class O
$CAD	CIG2634	CIG3634	CIG1634	CIG4634	CIG16082	CIG18082
$USD	CIG2635	CIG3635	CIG1635	CIG4635	CIG17082	CIG19082

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