MACKENZIE'S MULTI-STRATEGY ABSOLUTE RETURN FUND YEAR IN REVIEW

Mackenzie's Multi-Strategy Absolute Return Fund (MSARF) launched on May 23, 2018—the first Alternative Mutual Fund available to all Canadian investors filed under National Instrument 81-102 in a prospectus-based format offering daily liquidity. The purpose of the Fund is to provide Canadian mutual fund investors with a way to harvest diversified sources of alpha and alternative risk premia that are well-known to major institutional investors but are very hard to collect in traditional long-only strategies. Now that the Fund has passed its one-year anniversary, we look back at performance and market conditions since its inception.

Performance (May 23, 2018 – May 31, 2019)

Over the full period since launch, MSARF performance was a bit disappointing, but not alarming given the overall weak market context for alternative risk premia collection strategies that have very low beta to global stocks. The Fund was down 2.5% after Series F fees. To put that performance into context, the table shows a variety of market indicators for the same period (with the important caveat that none of these indexes include fees, so for comparison purposes we also show MSARF gross of fees).

The Fund's official benchmark is Canadian cash (Canadian 3month T-bills), which gained 1.6% over the same period. Over the same period, the HFRI Index (a widely-cited measure of hedge fund strategies), fell by -1.7% when expressed in CAD terms. Equity market-neutral hedge funds were down 1.7%, active macro hedge funds gained 0.7%, and credit hedge funds gained 1.6% (all pre-fee and in CAD terms).

For comparison purposes, global equities as per the MSCI World were basically unchanged in local currency terms over the same period. Regional equity markets were all over the map, with returns ranging from +3.1% for the mega-cap tech-driven S&P 500 to -4.7% for the Russell 2500 and -6.3% for the MSCI EM. A 60/40 global balanced portfolio was up about 3%. So outside of large-cap US equities and traditional government bonds, it was a volatile and somewhat difficult period, with quite lacklustre returns for hedge fund strategies on an after-fee basis.

Below we divide the trailing one-year period (inception to May 31, 2019) into two separate periods: launch until year-end 2018, which was dominated by an equity market sell-off that culminated in late December, and 2019 year to date, which has generally been a strong recovery environment through the end of April until equity markets stumbled again in May. As a reminder, MSARF can be viewed as a combination of three broad strategies—credit, macro, and equity long-short.

Strategy	Return
MSARF (Series F)	-2.5%
MSARF (Gross)	-1.1%
Cda 3mth Tbills (MSARF Benchmark)	1.6%
For reference:	
HFRI Composite*	-1.7%
HFRI Equity MN*	-1.7%
HFRI Macro Multi-Strat*	0.7%
HFRI Credit HF*	1.6%
MSCI World (LCL)	0.1%
Global 60e/40i (LCL)	2.9
S&P/TSX CAD	2.6
S&P 500 USD	3.1
Russell 2500 USD	-4.7
MSCI EAFE LCL	-5.0
MSCI EM LCL	-6.3

*May 2018 – May 2019, expressed in CAD terms. HFRI Indexes only available monthly.

Period Returns (%, gross of fees)	Inception – May 31, 2019	Inception – Dec. 31, 2018	Jan. 1, 2019 – May 31, 2019
MSARF	**-1.1%**	**-1.7%**	**0.6%**
Credit	4.3%	1.0%	3.3%
Macro	-2.9%	-2.2%	-0.7%
Equity L/S	-6.2%	0.3%	-6.5%
Contribution to MSARF gross returns by sub-strategy (bps)	Inception – May 31, 2019	Inception – Dec. 31, 2018	Jan. 1, 2019 – May 31, 2019
Credit	126	30	97
Macro	-93	-72	-21
Equity L/S	-230	16	-237
Risk Management Overlay	92	-141	225

2018

In 2018, MSARF finished the year with a negative return, driven primarily by the Global Macro sleeve and our long equity positions, which cost some return in Q4. Gains in the credit strategies and on the long-short equity portfolio helped offset these losses.

Long-Short Equity

The equity long-short portfolio is a market-neutral strategy designed to profit from two sources of returns: compensated equity risk factors that we expect to continue to generate positive returns over time (as they have in the past) and an equity alpha strategy. The equity risk factor portion of the strategy added significant value throughout the year. The strategy goes long a basket of stocks that score well on characteristics of low volatility, good value, quality balance sheets, and positive momentum, and shorts stocks that score poorly. We seek to collect attractive returns from this factor-based long-short security selection while remaining neutral to broad market direction. This process worked well in 2018 and added value and held up well during the weak months of October and December. The equity alpha strategy, which makes up a part of the total long-short equity sleeve and runs a proprietary alpha stock selection process on the stocks selected by the factor-based methodology, did not perform well as the specific longs and shorts selected in the US market did not generate good returns compared to the stocks selected outside the US.

Global Macro

Factor investing is not limited to picking individual stocks in the equity markets. A growing body of empirical research demonstrates clearly that factors such as momentum and value also persistently drive returns in the currency, commodity, and fixed income markets. In addition to these two factors, global macro economic activity and our position in the business cycle also have a significant impact on the relative behaviour of different asset classes. Our global macro sleeve is built to capture trade opportunities within and directional trade opportunities among these asset classes based on our readings of asset class valuations, momentum, and our assessment of the current macro economic environment. Historically, these kinds of strategies have been able to realise attractive positive returns over reasonable holding periods with acceptable volatility and insignificant exposure to the markets. The Global Macro sleeve within MSARF aims to identify and capture these types of returns.

Within the Macro sleeve, the Fund gained from its market neutral currency trades, specifically on the short Euro position and on various Emerging Market trades including short Korean Won, long Mexican Peso, and long Israeli Shekel driven by currency valuation and EM macro economic views. Meanwhile, relative value trades in the commodity markets underperformed. The strategy lost ground from long positions in crude oil and gasoline, long wheat and long nickel and zinc, all driven by measures of tightening global supply and improving trade flows. However, positions in natural gas (tactical timing between long and short) and precious metals (tactical timing between long and short) performed well, driven by views on inventories, demand, and short-term sentiment positioning. The macro sleeve entered Q4 with a tactical long equity trade, which dragged on returns a bit in October until that position was switched to a short, which benefited the Fund.

Alternative Credit

This sleeve is predominantly a credit momentum strategy. We allocate among various credit sectors (investment grade, high yield, loans and EM debt) to capture yield and attractive risk-adjusted returns. If/when these sectors lose momentum, rather than going short and being responsible for paying that high carry to someone else, we may instead go long a typically negatively correlated fixed income asset—5-year government bonds—and aim to benefit from positive price changes while collecting the albeit lower but still positive carry from these assets.

This strategy has worked very well for the Fund. Through much of 2018 we had an elevated exposure to credit sectors. For example, the combined High Yield and Loan allocations rose to as high as 53% of the sleeve in October 2018. When the high yield and loan market technicals deteriorated rapidly during October, these signals were picked up by the credit momentum model. These sectors were eliminated in November, replaced with high quality government bonds and cash equivalents. This significant change in allocation certainly benefited the portfolio during the risk-off month of December. The market environment over the past year was particularly conducive to a momentum strategy, as the magnitude of the moves following the model's signal shifts were large enough to contribute positive returns.

The alternative credit sleeve also maintained a small allocation to a long-short credit strategy. This strategy relies on fundamental credit risk analysis to identify individual debt issuers where we expect a near-term catalyst will drive their bond price lower. Over the 2018 period, this sleeve typically held 10-12 individual short positions in high yield bond or convertible debt issuers, somewhat balanced by long positions in the debt of issuers we considered fundamentally sound, to off-set some of the negative carry from shorting. Several short positions paid-off during Q3 due to idiosyncratic credit issues, and the sleeve's overall positive contribution was further enhanced by the risk-off nature of Q4.

Overlay

A performance drag also came from the Fund's small positive beta to equities, a strategic stance designed to allow a small and deliberate participation in general equity market growth. This is a feature that distinguishes absolute return funds like MSARF from market neutral funds. This stance produced a negative return that was in line with expected parameters given the near 20% peak-to-trough slide in equities. In general, though, exposure to equity markets was kept relatively low throughout the year, and we expect MSARF to usually run at a lower beta than both our Canadian-based peers and the broad HFRI Index.

December 2018

The Fund performed well in December—during a falling equity market when investors needed diversification the most—by holding steady amid a sharp equity bear market. Several of MSARF's strategies were positioned defensively going into December. This, plus the uncorrelated and market-neutral nature of many of the strategies, led to a flat month of performance. All three sub-strategies posted positive performance in December, with the equity beta overlay dragging returns back to zero for the month.

2019

2019 has been better so far in terms of the Fund's absolute performance. MSARF is up approximately 60 bps year-to-date. Gains in the macro strategies and in absolute return fixed income have helped offset weakness in long-short equities. While the Fund lagged gains seen in traditional stocks and bonds this year, investors should be reminded that MSARF is not designed to capture broad stock market gains the way a long-only relative return fund might be. Investors using this strategy should expect it to deliver a positive absolute return over a market cycle, but it is not designed to outpace a strong equity bull market.

Global Macro

Within the Macro sleeve, our currency positioning in Emerging Markets and the Euro region continued to pay off as economic conditions in those regions weaken and continued uncertainty both politically (Brexit) and economically caused weaker currencies. The relative value commodities strategies continued to struggle, driven by positions in agriculture as global inventories continued to grow while global trade frictions became a bigger driver of price swings. So as much as the political uncertainty has benefited our currency strategy, it has reduced the efficacy of the commodity models in 2019. Relative sovereign fixed income positioning was flat. Specifically, our long in German Bunds added value, but was offset by our short in Canadian 10-year bonds. Similar story in relative equity, where our overweight in Swedish equities was a positive contributor but was offset by our short in Swiss equities.

Finally, within the macro sleeve there is a small tactical market timing element. Our asset mix tilts added value as both fixed income and equities markets were up in 2019. With respect to equities specifically, the tactical timing strategy went short stocks in November—to beneficial effect for the Fund—and went long stocks again in mid-February. So, what we made with the short call in late 2018, we lost by remaining short in the opening weeks of 2019, and then profited again by remaining modestly long thereafter.

Any lucrative investment strategy comes with risk and will be subject to periods of relatively weak performance. To benefit from the return enhancement and diversification potential of this strategy, it is imperative that investors embrace the foundations on which it is based before investing so they may be in a better position to hold on during periods of underperformance. Global macro strategies such as trend following have consistently been among the better-performing alternative strategies in periods of equity market crisis, despite going through their own periods of difficulty from time to time. Other macro strategies tend to be disconnected from equity market ups and downs. It is because of these attractive diversification properties that our Multi-Strategy Absolute Return Fund contains a significant allocation to global macro.

Alternative Credit

The alternative credit sleeve has extended its good run of performance since inception by delivering five positive months of performance in a row in 2019. As we moved into the new year, the sleeve was in risk-off mode and heavily allocated to government bonds. Positive momentum returned to risk assets in January, including the higher yielding segments of fixed income markets, and our models signaled to initiate positions again in high yield, loans and EM debt. The signal timing was such that the Fund was able to participate in much of the subsequent rally in these sectors, contributing positively to returns. There have not been any significant changes to the asset mix in the last couple of months.

The risk-on rally in credit markets during Q1 caused the long-short fundamental credit sleeve to contribute small, negative performance within the alternative credit strategy's overall positive results. Since inception performance of the long-short sleeve has been positive. Several long-short positions have changed over the since inception period, as the fixed income team realizes views and changes positioning based on outcomes. Diversification of long-short positions is an always-important consideration. Ten fixed income sectors are currently represented in this sleeve, among them: Financial Services, Technology, Automotive, Consumer Goods, and Healthcare.

Long-Short Equity

Market-neutral equity strategies have underperformed this year, both in our Fund and across the industry. 2019 has been a significantly negative year for almost all quantitative equity managers and we have not been spared the performance decline. While the compensated risk factors we favour (equity factor strategies discussed above) have been down by less than other strategies, this has been small consolation given that the stock selection models within our long-short equity alpha strategy have been consistently "upside down", meaning that tilts that have worked for decades to generate positive returns have lost money, while tilts that have destroyed value for decades have suddenly made money this year. Said differently, the longs selected by the systematic process have not performed well and have been soundly beaten by stocks with different (worse) characteristics.

With the benefit of hindsight, it would have been better to do the OPPOSITE of our strategy. But on a go-forward basis, would it make sense for us to begin going long expensive, volatile stocks that are growing slowly and have low-quality financial characteristics, and shorting the market's "best" stocks? That statement doesn't really need an answer, but we do need to account for how we are approaching this market environment.

Simply put, there is nothing to do but wait. While our shorts have made money, our longs—the unique subset of stocks that score highly on all our criteria—have generated poor returns. We don't expect this to continue forever. We buy stocks that have positive growth characteristics, good valuations relative to peers, high quality earnings and balance sheets, lower volatility than peers, and positive price momentum, and we short stocks with the opposite of these characteristics. What we WILL NOT DO is start overriding our systematic process by adding our judgement, or anything else. Our investment philosophy has consistently performed well for several decades. The current period of underperformance still measures in months.

Overlay

The Fund's small positive beta to equities contributed 277 bps to return on a year-to-date basis, in line with expectations, as equities had a strong positive performance. Since the Fund's inception, the 92 bp contribution from the overlay is in line with expectations and consistent with the relatively modest advance in the MSCI World over the same period.

General Observations on Performance

As we review the performance of the Multi-Strategy Absolute Return Fund since its inception in May 2018, some observations are worth noting.

- A couple of the strategies have exceeded expectations, namely the Credit Absolute Return strategy.
- The strategies have been performing in line with expectations, in that none of the live track records fall outside of the predicted possible range of outcomes over the one-year horizon.
- We have faced a market environment that has not been kind to alternative risk premia collection strategies.

On the last point, we are not alone in this. According to a May 13, 2019 Pensions and Investments (P&I) Special Report on Alternative Risk Premium Strategies, *"The performance of most alternative risk premium strategies, by industry definition actively managed multi-asset, long/short, factor-based approaches, was negative in the year ended December 31 (2018). That's because the four main factors many alternative risk premium investment models rely on—value, momentum, carry and defensive—were down or flat during the period, something sources say is extremely rare. In fact, 2018 was the only year in the past seven when alternative risk premium strategies produced a negative average return."*

It's a bit of a consolation to see that other major players in the liquid alts space have also faced the same challenges we have faced over the past year, and that these major players have felt the need to revisit first principles to confirm the validity of the approach both they and we are taking in this space. The P&I Special Report cited research by AQR Capital Management Inc. (a leading manager in this space worldwide with over $US56 billion in alternative risk premium strategies and a manager of risk premia strategies similar to our own). The report found no evidence that the world has changed by enough to make its models invalid; rather, they remained very much convinced that the approach was right and that an alternative risk premium strategy is a good source of return and diversification to traditional stocks and bonds. In fact, P&I reported that several managers are reporting inflows from institutions keen on "buying the dip" in these strategies.

One explanation offered for the irrationality of current markets is the extreme political and economic uncertainty, where winners and losers are not only determined by traditional financial metrics but by whether they are perceived to be winners or losers of the "tweet war". This may continue for some time (perhaps years).

We believe that the key for investors is to include a range of uncorrelated liquid alternative strategies in their portfolios, so that a bad period in one strategy or asset class doesn't become the whole story. Investors should benefit over time when they tap into a range of strategies that invest long and short across many assets and factors, creating an uncorrelated alpha source to complement returns from traditional stocks and bonds.

Conclusion

The ideal investment to add to your model portfolio has three characteristics: An attractive absolute return, low volatility, and a low correlation to what you already own.

Over the very long term, an index representing a collection of alternative strategies has been able to achieve a good combination of those characteristics. Replicating this kind of return stream in an accessible daily liquid mutual fund continues to be the aim of the Mackenzie Multi-Strategy Absolute Return Fund.

Like all investments, generating a real return from alternative strategies requires taking on risk. This means they may not consistently generate positive returns over short time periods, and there will be periods during which they generate negative returns. The benefit of diversification is that these periods of weak performance are unlikely to consistently occur at the same time as other elements of your portfolio are suffering, and over a full market cycle, diversification will help generate a positive absolute return.

Looking at rolling 1-year returns, based on monthly data, going back to January of 1990, there have been 36 periods in which global equity returns were negative while alternative strategies were positive (none since MSARF launched). Over the same time horizon, there have only been 8 periods where alternative strategies were negative while global equities were positive (two of those occurred since the launch of MSARF).

This has been a difficult time for alternative strategies in general, but this has occurred in the past, and will likely occur again in the future. The engine driving the attractive returns of liquid alternative strategies (the isolation and amplification of alternative risk premia and alpha sources through leverage and shorting) does not appear to be impaired in our opinion or in the opinion of some of the world's largest institutional investors, who continue to keep an important allocation.

Since the Global Financial Crisis (GFC), equities have returned roughly double their historical average with less volatility. Will the next 10 years be as productive for this asset class? Probably not.

The annualized return on global high-quality bonds between 1990 and the GFC was more than double what they have returned since, and bond yields currently sit at historic lows. What will the next 10 years hold for this asset class? Difficult to say, but it appears that 30 years of falling interest rates may be behind us.

Being well diversified has never been more important than it is today. Holding a diversified mix of alternative strategies is now an easy way to significantly enhance your level of diversification and reduce total portfolio volatility without sacrificing return. This can now be achieved with the addition of a single, daily liquid mutual fund. We firmly believe that the addition of a diversified package of alternative strategies is the best tool investors have to enhance the risk/return profile of their overall portfolio.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

This document may contain forward-looking information which reflect our or third party current expectations or forecasts of future events. Forward-looking information is inherently subject to, among other things, risks, uncertainties and assumptions that could cause actual results to differ materially from those expressed herein. These risks, uncertainties and assumptions include, without limitation, general economic, political and market factors, interest and foreign exchange rates, the volatility of equity and capital markets, business competition, technological change, changes in government regulations, changes in tax laws, unexpected judicial or regulatory proceedings and catastrophic events. Please consider these and other factors carefully and not place undue reliance on forward-looking information. The forward-looking information contained herein is current only as of May 30, 2019. There should be no expectation that such information will in all circumstances be updated, supplemented or revised whether as a result of new information, changing circumstances, future events or otherwise.

Index performance does not include the impact of fees, commissions, and expenses that would be payable by investors in the investment products that seek to track an index.

81-102 requires that the reasons for the differences in performance data between the series'/classes be disclosed

The fees and expenses are higher for A than for F. The management fee and administration fee associated with A is 2.25% & 0.28% respectively, whereas the management fee and administration fee associated with F is 1.15% and 0.15% respectively.

998560 6/19

MACKENZIE
Investments