Mackenzie Core Plus Global Fixed Income ETF (MGB)

Series F Quarterly Commentary As of September 30, 2020

Key takeaways

- Developed market yield moves were mixed over the quarter, though remained anchored at lower levels overall. In the U.S., the Treasury curve modestly steepened alongside the broader rally in risk assets. Rates in the U.K. and Japan remained similarly range-bound, while rates in Germany generally fell across the curve.
- Credit U.S. investment grade credit spreads tightened 14 bps, ending the quarter at 128 bps. The sector returned 1.50%, while U.S. HY bond returned 4.60% and leverage loans performed 4.6%. Credit was supported by continued central bank corporate purchases and faster than-expected economic recovery, but volatility returned late in the quarter with a return of geopolitical tensions and US election concerns.
- The fund produced a quarterly return of 0.9%, outperforming its benchmark which returned 0.8%.

As of Sep 30, 2020	3M	YTD	1Y	3Y	SI*
Mackenzie Core Plus Global Fixed Income ETF	1.2%	7.0%	8.2%	3.8%	3.3%
ICE BofAML Global Broad Market Index (Hedged to CAD)	0.8%	4.9%	4.3%	4.7%	-
Global Fixed Income Peer Group	1.0%	4.5%	4.0%	3.6%	-
Percentage of Peers Beaten	52	75	89	50	-

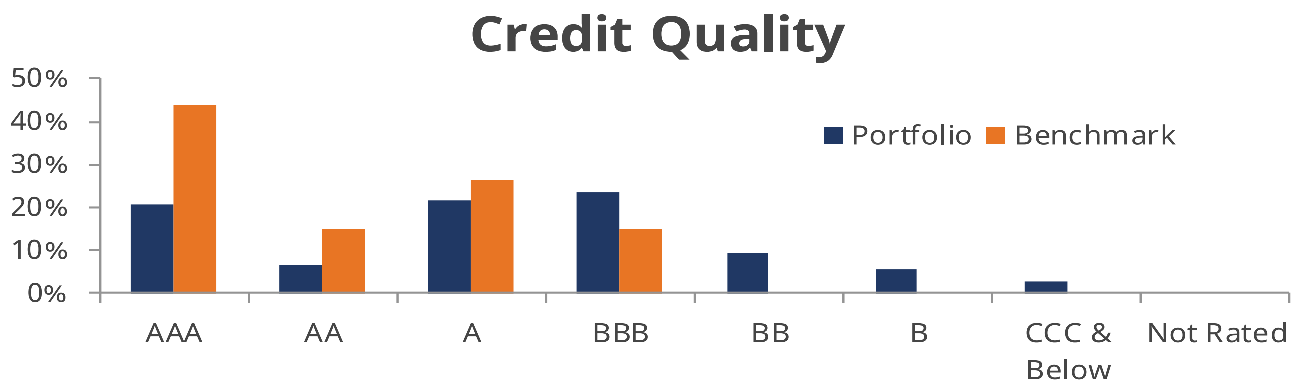
*SI: Since inception date: April 19, 2016

Asset mix	Portfolio	Benchmark
Government	38%	54%
Emerging Markets	16%	3%
Loans	5%	0%
High Yield	5%	0%
Investment Grade Corporates	24%	20%
Other	1%	24%
Cash & Equivalent	12%	0%

Country Allocation	
United States	27.0%
Canada	15.3%
Other	45.3%
Cash & Equivalents	12.4%

	Portfolio	Benchmark
Credit Quality	A	AA
Duration	6.5	7.5
YTM	2.9%	0.7%

Currency Exposure (gross/net)		
	Gross	Net
USD	38.6%	-0.9%
CAD	28.4%	78.6%
CNY	7.8%	7.8%
AUD	6.2%	0.2%
Other	19%	15.2%



Quarterly fund performance review

Key contributors

- Pro-risk allocation resulted in outperformance relative to the benchmark
- Inflation Linked Bonds posted solid returns
- EM local currency exposure added significantly

Key detractors

- Allocation to Russian assets detracted from performance
- Outperformance of European duration vs. North American
- CAD underweight vs. G10s

Fund activity and positioning

- Developed countries: the PM added exposure in Sweden, extended duration in Australia by switching 10yr holdings into 30yr bonds. In addition, the short position in Italian Futures was closed
- The exposure to China government bonds was increased on opportunities and now stands at 8% of AUM.
- Inflation linked bonds (ILB): the manager reduced position in Inflation-linked performance both outright (sold ILB for cash) and vs. nominals (sold ILB to buy Nominals) - this resulted in a reduction of duration of the overall portfolio from 7 at the end of June to 6.4 at the end of September.
- Exposure to emerging markets was increased both in hard currency debt and local currency on countries like Bermuda, Brazil, Russia, Mexico, South Africa.

Top Credit contributors to Fund performance – September 2020

Investment Grade Bond – Algonquin Power Corp (multiple lines)

- For the first time in six months, credit spreads widened in September, with Bloomberg's Canadian IG Credit index out by 7 bps to a level of 138 bps. Despite recent spread widening in the utilities sector and the BBB rating category, Algonquin Power Corp bonds have performed well through the month and year to date and over the past decade. Algonquin Power & Utilities Corp has grown revenue and cash flow by almost 10x since their first corporate bond issue in 2011, and they've seen an improvement in their credit rating over this time. Algonquin is well known for their presence in the renewable power generation market – particularly their hydroelectric facilities. The Liberty Utilities division represents about 70% of cash flow and provides regulated electric, gas, and water services for roughly 1 million customers in the United States. And Liberty Power represents 30% of cash flow and provides renewable energy with a generating capacity of 3,000 MW that is 80% wind and the rest a mix of solar, hydro, and thermal in Canada and the United States. Sustainability has always been part of the company's story but has received increased emphasis with its first Sustainability Day in late 2019 along with regular sustainability reporting. Key targets towards 2023 include adding 2,000 MW of renewable energy, exceeding 30% women in leadership roles, and publishing TCFD-aligned disclosure starting in 2020.

High Yield Bond – Uber Technologies Inc (multiple lines)

- Uber is relatively new to the market after having just completed its IPO in the equity market in 2019, but we've been a lender to the business from before they were a public company. Although unprofitable, we saw an opportunity to lend to a market leader in a fast-growing market with a large equity cushion to support our bonds. COVID-19 put our thesis to the test, as the downturn in the economy caused by lockdowns resulted in a significant drop in ride bookings, but that was partially offset by a massive increase in the Uber Eats delivery side of the business. The overall business did take a hit in 2020, but they have since rebounded back to 80% of 2019 levels and have reiterated its commitment to be EBITDA positive before the end of 2021. The COVID-19 shock has allowed Uber to demonstrate the strength of its diversified operation, focus on profitability by exiting unprofitable/highly competitive markets, proving that they are maturing as a dominate company in the technology space. Uber has had its governance issues in the past, but our internal score of the company has vastly improved as they restructured their board to now have more than 2/3rds independent directors and more than 20% of whom are female.

Leveraged Loan – Institutional Shareholder Services TL B 1L USD

Institutional Shareholder Services (ISS) provides corporate governance and responsible investment solutions for asset owners, asset managers, hedge funds and asset service providers. We initiated a position in their loan last year in conjunction with their acquisition of Strategic Insight, making us one of the largest lenders to the company. At the height of the crisis in March, the loan traded down along with the market and fell by 15 points, as investors were looking to sell first and ask questions later. We decided to hold, as our analysis had determined that their business model would be recession-resistant given the strong industry tailwinds behind increasing shareholder activism and institutional focus on ESG matters and responsible investing. We also recognized that they have a dominant market position with >50% client share in proxy voting and research. Since the market lows in March, the company has reported strong Q2 results that demonstrated low-single digit topline growth with high client retention of ~95%, validating our thesis that they are a recession resistant business. Their TL has since provided a strong total return and has traded up closer to par.

Markets highlights

Credit Market index	Spreads	MTD	YTD	2019
US High Grade *	144	-0.3%	6.6%	14.2%
US High Yield **	541	-1.0%	-0.3%	14.4%
S&P LSTA Loan Index	493	0.6%	-0.7%	8.6%
			Moves (bps)	
Rates	Yields	MTD	YTD	2019
US Treasury 10Y	0.71%	2	-124	-77
Canada Govt 10Y	0.62%	6	-114	-27
US Libor 3M	0.24%	1	-167	-90

Data as of September 30, 2020. Source Bloomberg and S&P.
**ICE BofAML US Corporate Master Index. ** ICE BofAML US High Yield Master II Index*

Macro outlook and fixed income perspectives – Q4 2020

While Q2 2020 will be remembered as a truly challenging and transitional time for our economy and society, from a markets perspective Q3 2020 is likely to be remembered for the quick snap-back in the economy as some workers and many students transitioned back to work and school for the fall as the various reopenings took shape.

The "V-shaped" part of the "Nike Swoosh" seems to be well underway, but it is almost certain that both here in Canada, as well as in the US, when the economy get to the "leveling out" part of the swoosh it is going to be notably short of where it was in February 2020, both in terms of nominal output as well as the number of employed persons. This will leave a structural output gap in the economy that will take time to heal, measured in years.

In the meantime, key metrics like the ISM data in the US as well as Non-farm payrolls continued to indicate a strong bounceback throughout the third quarter, as did key emerging market data like China's ISM. Global growth is bouncing back more quickly than many thought: in September the OECD said it now expected global growth to contract by 4.5% in 2020, a stark difference from its June prediction of a 6.0% contraction. These are large swings and underscores the challenging and unprecedented environment we are – and will continue to be – in for many quarters, if not years to come.

Central bank stimulus – and particularly the Fed's stimulus programs – continued to underpin market confidence in the third quarter with risk assets generally rising. 10-year US Treasuries were little net changed and the 2s-10s spread were also little net changed on the quarter but not without some drama around higher yields / wider spreads in August on the back of accelerating fiscal / Phase 4 stimulus talks at the time as well as anticipation of the Fed's long-awaited announcement of the new Average Inflation Targeting framework that was rolled out at it's annual Jackson Hole Symposium to somewhat muted fanfare. The USD continued to generally be sold on rallies as the notion of US exceptionalism continued to dissipate and expectations of Fed "printing" remained very much top-of-mind.

Towards the end of the quarter emphasis on the key market themes started to shift with less weighting on the Covid situation and more towards the potential outcome of the US election. From here through November 3 –

and likely beyond – the market will likely be transfixed with the headlines and be the key driver of sentiment at least to close to the middle of Q4. As we write, Trump has been recently released from the hospital on the back of his positive Covid diagnosis and national polls seem to be ticking higher in favour of Biden who already had a bit of momentum coming out of what was by many accounts a pretty disastrous first presidential debate from both sides. But many of the national polls are likely overstating the real state of play of the election; state polls performed by proven polling firms with a recent history of accuracy would suggest the race is a lot closer although still in favor of Biden. Within the eight or so key battleground states, Pennsylvania, Michigan and Wisconsin continue to be the key for the election – and you can see it by the amount of time each campaign spends in those states. We are also watching Nevada, Arizona, Florida, North Carolina, Minnesota and New Hampshire as key metrics.

Recent fixed income price action in the days prior to writing has been telling with how election results might impact our markets. We believe a "Blue Wave" that sees Biden with the White House *and* the Senate flip to Democratic rule would be negative for fixed income markets, particularly at the longer end of the curve 10 years and out – but with a giant caveat: The Fed is still there and isn't going anywhere. A Blue Wave is likely to ease the path to large fiscal spending – both in the form of relief funds as well as infrastructure spending – and more easily assure legislation passage than the current stalemated congress. This likely means more issuance / supply and much more than the Treasury currently has budgeted as well as a weaker USD. A Biden Presidency also – somewhat ironically – probably helps ensure continuity with a Powell-led Fed with more of the same "whatever it takes" easy policy in the pipeline despite Powell being Trump's appointment.

The key caveat here through is the Fed. We believe the Fed is likely to want to show it intends to keep longer end rates lower or even capped to encourage business investment, particularly with small and medium sized businesses, as well as longer-term durables consumption. We think the Fed will do this, possibly in Q4 at either its November or December meeting, via adjusting the weighted average maturity (WAM) of its "Covid-QE" purchases from the current approximate 5-year average to something closer to 10 years. This could also be accompanied by an increase in the current $80bn / month program that sees the Fed mop up additional supply although we believe the WAM action is the higher probability event. Accordingly, we do not see yields running away materially higher on a Biden presidency or Blue Wave with the Fed's "hammer" waiting in the wings.

For us heading into November's election it is just as important to watch the Senate race as it is the Presidency; a Biden Presidency with a Republican Senate will have very different implications for policy than a Biden Presidency and a Democrat-led Senate. As we write the race in the Senate is too close to close to call. We are keeping an eye on a number of Senate races, particularly those in Arizona, Michigan, Maine and North Carolina. Any one of those could end up tipping the balance in either direction.

And we would be remiss if we did not address the now well-understood issue of mail-in and absentee ballots, something we were discussing as a risk internally back in April and May when the theme was very focused on Covid. To us, there is a high probability of some gamesmanship in the days and weeks post election due to the sheer number of mail-in and absentee ballots that will need to be processed in 2020 versus previous elections. Simply put, it takes time and many states to not have the infrastructure in place to count all those votes expeditiously. As of Monday October 5, 3.8 million ballots had already been cast as part of the 2020 election. The equivalent at this point in 2016? 75,000. Those three key swing states – Pennsylvania, Wisconsin and Michigan – have three, seven and 14 days, respectively to count their ballots. To us there seems to be ample room for issues to arise and risk off trades around the election make some sense still at least directionally, although vols across asset classes are, no surprise, extremely expensive now with this idea well baked into the price.

All told we continue to believe yields will continue to remain capped even if the long-end does run a bit higher from here and the USD will remain a sell-on-rallies proposition generally as we work through the fourth quarter and into early 2021. With a medium-term outlook in mind, any spike higher in long-end yields or the USD should be faded.

Duration

Our views remain broadly the same – with a slight downgrade in our view on duration. Which went from somewhat bullish to neutral. The massive amounts of new issuance have so far and will likely continue to be met with central bank buying. This seems to prohibit significantly higher yields even in a more reflationary environment while still offering some positive performance in risk-off episodes. This notion might get tested more meaningfully with the upcoming US election – mostly likely if a democratic sweep were to occur. Moderately higher rates due to a more positive environment for markets seems to be tolerable by the FED, while yield rises due to supply fears and/or fading FED support and/or a dramatic shift higher in yields are not. Based on communication by the Federal Reserve, we do not expect negative policy rates in the US. This however does not preclude bonds to trade at negative levels during heightened stress. Canadian QE supports the domestic yield curve similarly. In general, we continue to prefer US rates over Canadian.

Curve positioning

The US and Canadian yield curves have still the potential to converge closer to the respective policy rates. The long end will remain the most volatile part of the curve even on a yield basis as the short end seems to be firmly anchored. The upcoming US election has the potential to introduce larger moves based on the longer-term structural shift that might come about. We prefer much of our duration expression in the belly of the curve, where we get the maximum pull lower from policy rates (anchor) and also see disproportionally large QE buying.

TIPS

TIPS had another solid quarter with breakevens recovering plenty of the lost ground. Real yields are now aggressively negative throughout the whole curve. TIPS offer an interesting investment by combining the real economy and financial markets as they are part financial asset (real yields) part observed inflation (real economy). Observed inflation has risen significantly in the past few months – this bodes well for future YoY inflation readings. Long end breakevens are close to the yearly highs – reflecting the optimism of the reflation trade and the risks that unprecedented stimuli might have.

EM

EM debt performed well in Q3 2020 – this applies to both local as well as hard currency bonds. While there are plenty of challenges around in the Emerging Markets space, the combination of attractive yields and a stabilization in performance has attracted interest. The weakness of the USD paired with the firmness and low levels of US Treasuries offered macro support for the asset class. We tend to have a preference for EM local over hard currency debt, despite its larger volatility. Valuation looks significantly more attractive.

Investment grade

For the quarter ending Sep 2020, both the US Investment grade bond index and the Canadian investment grade bond index returned 0.62% (*using Bloomberg Barclays US Aggregate Total Return Index LBUSTRUU*) and 0.44% respectively. Much of the performance can be attributable to continuous spread tightening during the quarter.

As expected, corporate bond supply was back to a more normal pace in Q3-2020 after the highest quarterly gross bond issuance in Q2-2020. Gross investment grade bond supply in the U.S. during the quarter was 7.6% above that during the same period in 2019, as U.S. corporations continue to take advantage of the low yielding environment to term out near term debt. In Canada, Q3-2020 corporate bond issuance volume was 26% below Q3-2019 level, as issuance by Canadian banks have declined. Regulatory changes have reduced the need by Canadian banks to issue and that it has been more cost advantageous for banks to issue outside of Canada.

With the gradual re-opening of the North American economies, accompanied with improvements in economic statistics and continuing supportive Central banks' policies and fiscal responses, both provincial and corporate bond spread continues to narrow. On average, Canadian 5-year corporate bond spread decreased by 31 bps during the quarter. Likewise, on average, 10-year provincial bond spread was lower by more than 6 bps.

We expect that investment grade corporate bond spread would continue to be supported by increasing investors demand as cash continues to find its way into fixed income funds, against lower bond supply for the remainder of the year. The headwind to our view is: a) the possibility of the coming of a second wave in Covid-19; b) the outcome of the U.S. election; and c) rising trade tensions generally. Also, different sectors would recover differently in a post-pandemic world. We remain biased to maintain high exposure in selected high-quality liquid corporate bonds.

High yield market

Although the high yield market has materially rebounded from its lows and recovered from most of the losses, we still see some value on a relative value basis given the unprecedented monetary policy holding rates near zero, as well as the large corporate bond buying program that has supported most areas of credit. The Fed's corporate bond buying program has removed the tail-risk of a large market sell-off and/or a spike in default rates, but credit is not completely shielded from the major macro drivers that continue to be present despite the rebound in the markets.

Technicals and fundamentals are supportive of the continued recovery in the high yield market. We note, among other things:

- The high yield market now yields 5.8% and has a spread of 541 bps, which is near the long-term average spread of 550 bps.
- The overall quality of the issuers in the index is higher than at any other time in history with a record 56% rated BB.
- Primary market continues to be open to companies to provide much needed liquidity and refinancing opportunities, with a majority of the supply continuing to be higher quality from a rating and/or structure perspective.
- Inflows continue into high yield, as the Fed programs continue to support the corporate debt markets.
- Credit fundamentals began to stabilize in Q3 as the economy gradually recovered with business reopening and jobs returning, rebounding from the massive deterioration we saw in Q2 due to he economic shutdowns.
- LTM default rates in high yield have increased sharply from the beginning of the year, but the Fed programs and open primary markets to provide liquidity appear to have helped avert the worst case scenario that was predicted earlier in the year.

The high yield market has fully recovered from being down as much as 20% in March, and is now showing a positive 0.67% YTD return (to October 7th). We acknowledge that the easy money has been made, but still see some value in this low yield environment with 10-year US treasuries yielding less than 1% and over $15 trillion of global bonds with negative yields. We believe that the 5.8% yield is attractive on a relative value basis, and see an opportunity to continue to collect the above average coupons through the end of the year, supported by the low interest rate environment and Fed bond buying programs. We also expect that the high yield market will further be supported by a continued improvement in corporate earnings through the end of the year. From a macro perspective, there are a number of threats that continue to loom over the markets, so we do anticipate some volatility and hope to be able to capitalize on those opportunities in our mandates.

Leveraged loans

The loan market is still cheap on relative value basis but is not shielded from how macro drivers (primarily the US election and covid-19) will impact equity and credit markets.

Technicals and fundamentals are supportive of the continued recovery in loans. We note, among other things:

- The average price of loans is still at 93.2, with 5.7% YTM and 500 spread over LIBOR
- New CLO formation is at $63 bn to Oct 13th, with over $10 bn expected to price in Q4
- Outflows continue to leave the loan asset class but have slowed down materially, even with small positive weekly inflows coming sporadically
- Credit fundamentals have deteriorated in 2020 due to huge drops in earnings and EBITDA (due to economic shutdown in Q2 and Q3), but expected to recover in 2021 especially in the sectors not hugely impacted by covid-19
- LTM default rates in loans have moved up recently, but remain at 4% which are in only slightly higher than historical averages

With loans' total return still in the red YTD (to Oct 13th), we expect more recovery in loan prices throughout Q4. The primary risk facing us is the result of the US election. Additionally, Covid-19 data, trends and stories will most definitely continue to impact the direction of markets, with other macro drivers like trade with China and geopolitics taking a back seat. Earnings got hit in Q2 and investors will be watching for improvements going forward. Q2 was heavily characterized by monetary stimulus from Central Banks and elevated levels of volatility in markets. Q3 witnessed the gradual reopening of the economy and a substantial decrease in market volatility. Q4 will be about the US election and its impacts on markets. Eventually, we believe there will be more focus on corporate earnings in 2021.

In summary, we expect loans to trade range-bound with a tilt to the upside, with volatility in the secondary market to revert to normal levels and the primary market to continue to open up. Q3, in our view, is a good example of how things may look like in loans for the remainder of the year!

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