MACKENZIE Investments

March 31, 2021

Series F

Mackenzie Unconstrained Fixed Income Fund

Fund Snapshot

Inception date	12-03-2014
AUM (millions in CAD)	$3,221.41
Management Fee	0.55%
MER	0.76%
Benchmark	FTSE Canada 91 Day T-Bill Index
CIFSC Category	High Yield Fixed Income
Risk Rating	Low
Lead Portfolio Manager	Steve Locke
Investment Exp. Since	1995

Strategy Overview

- Seeks a positive total return with low volatility over a market cycle and throughout various economic environments.
- Benchmark agnostic and flexible across the entire fixed income spectrum, managed within a credit focused framework, employing additional sources of alpha: tactical duration, dynamic allocation and credit management.
- The neutral currency exposure is 100% hedged back to CAD, however currency positions can be used tactically for alpha and to manage overall risk in the portfolio (generally no more than 10% to 15% open positions).
- Uses an "always-on" hedging strategy to manage the downside risk associated with the High Yield bond exposure (riskiest sleeve).

Highlights

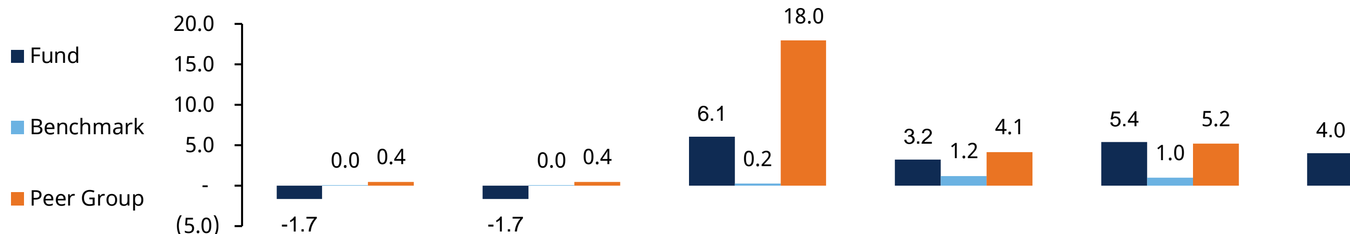
Contributors

- Fund's exposure to high yield bonds and floating rate loans contributed to the performance with index returns of 0.90% and 1.78% respectively for the quarter

Detractors

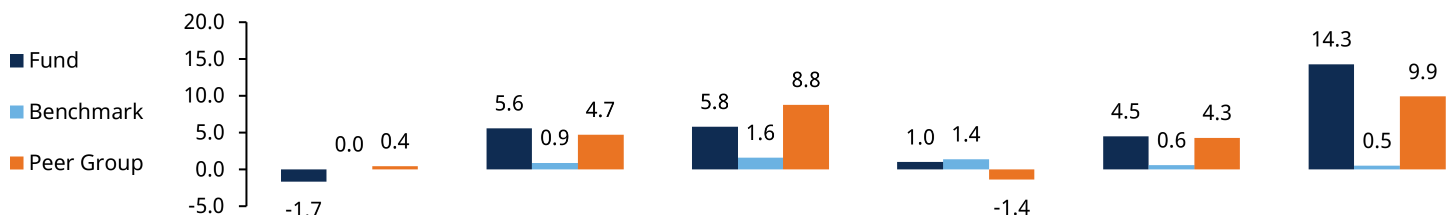
- Exposure to government bonds and investment grade corporates detracted from the performance as yields rose on higher bond supply and inflation concerns

Performance Chart



	3 Mth	YTD	1 Yr	3 Yr	5 Yr	SI
Excess Return	-1.7	-1.7	5.8	2.0	4.4	-
% of Peers Beaten	9	9	1	40	52	-

Calendar Returns



	YTD	2020	2019	2018	2017	2016
Excess Returns	-1.7	4.8	4.2	-0.4	4.0	13.8
% of Peers Beaten	9	66	19	81	49	0

Source: Mackenzie Investments, Morningstar Direct.

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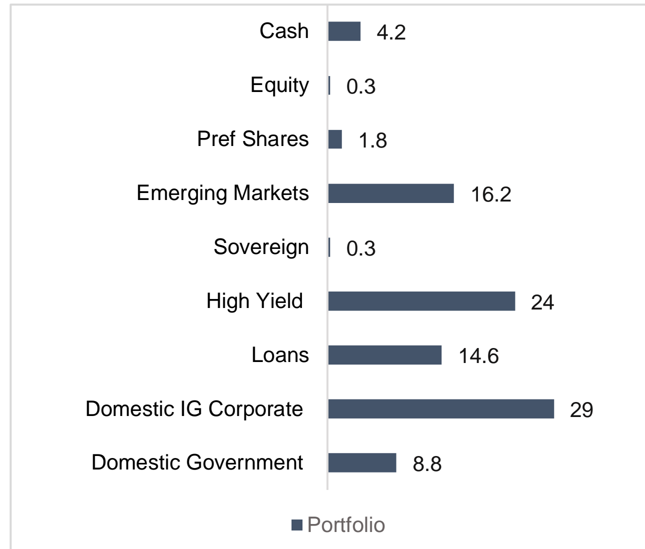
Asset Mix



Maturity Breakdown

Bucket	Portfolio	Benchmark
0 to 3	17.21	-
3 to 7	49.23	-
7 to 12	24.92	-
12+	8.63	-

Currency Exposure

Currency	Gross	Net
CAD	39%	99%
USD	45%	2%
Other	15%	-1%

Performance Metrics (3 Year Trailing)

Metrics	Portfolio	Benchmark
Standard Dev.	3.1	0.2
Alpha	2.0	-
Beta	-5.3	-
Sharpe Ratio	0.7	-
Tracking Error	3.2	-
Information Ratio	0.6	-

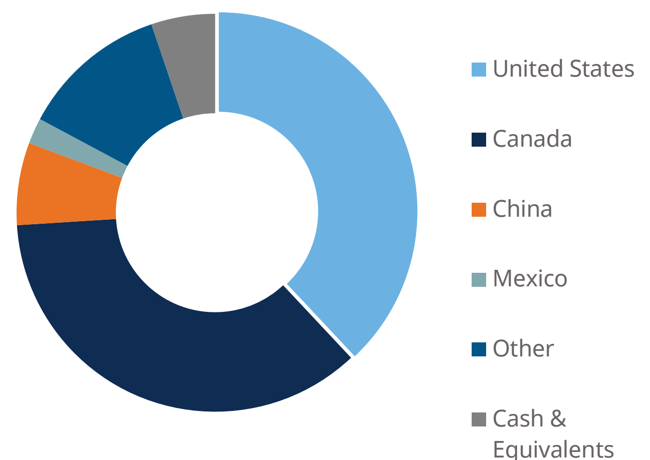
Characteristics

Ratios & Metrics	Portfolio	Benchmark
YTM	3.50	-
Duration	3.12	-
Avg. Credit Quality	BBB	-
Avg. Price	110.05	-
Avg. Coupon	4.16	-
Avg. Term	4.65	-

Credit Breakdown

Rating	Portfolio	Benchmark
AAA	2.31	-
AA	17.59	-
A	19.06	-
BBB	18.81	-
BB	17.70	-
B	18.29	-
CCC & Below	4.94	-

Geographic Allocation



Source: Mackenzie Investments, Morningstar Direct.

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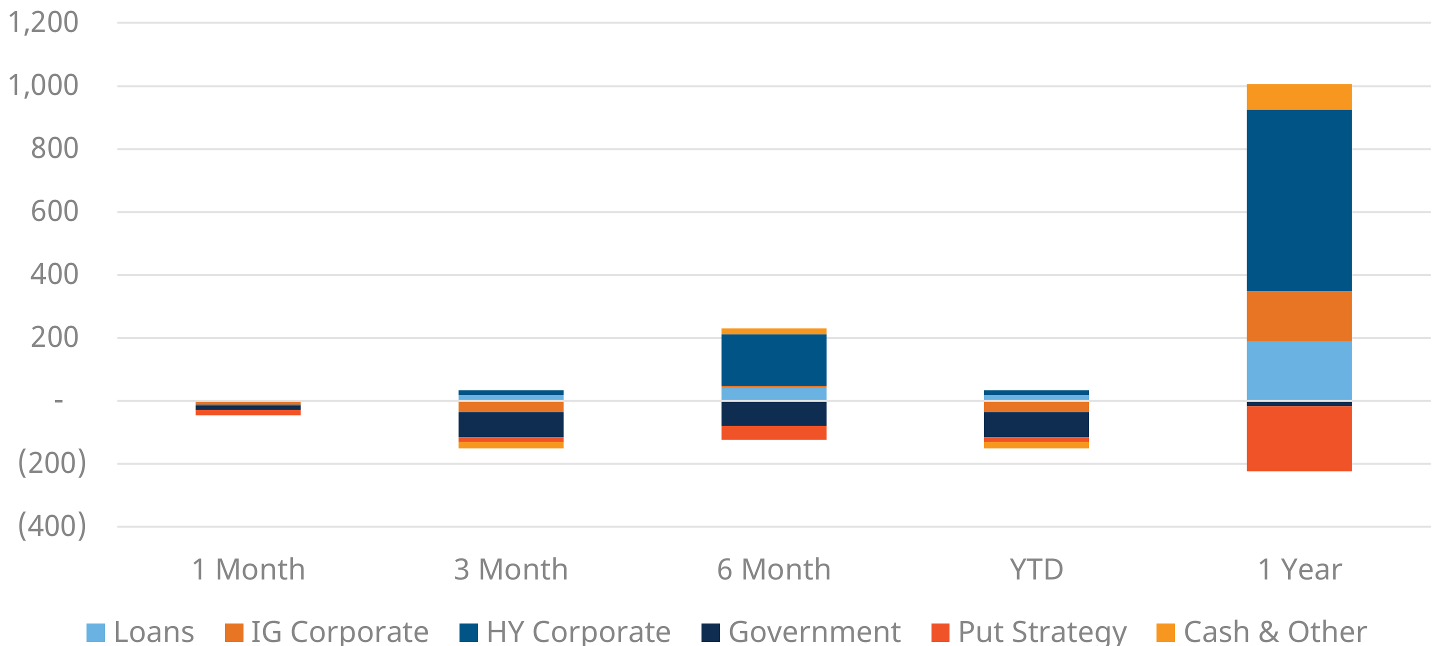
Attribution



Market Overview Commentary

- The first quarter of 2021 has seen a significant upward adjustment in global bond yields. The brighter outlook going forward based on vaccines, re-openings, nascent inflationary pressures and fiscal stimuli provided the fertile ground for the reflation story. While we believe that we could see a further normalization in rates, we do not expect that same pace to continue. The world appears too fragile still to tolerate another major leg upwards in yields at this stage. With ever increasing amounts of issuance (via already proposed fiscal spending & newly proposed) paired with only gradual revenue increases on the other side – FED purchases look like they would need to continue for quite some time. The FED and other central banks have continually asked for more fiscal to complement the monetary stimulus – now that they are finally seeing some signs of getting it; it would be foolish to abandon their role and let pure market forces determine where prices should settle.

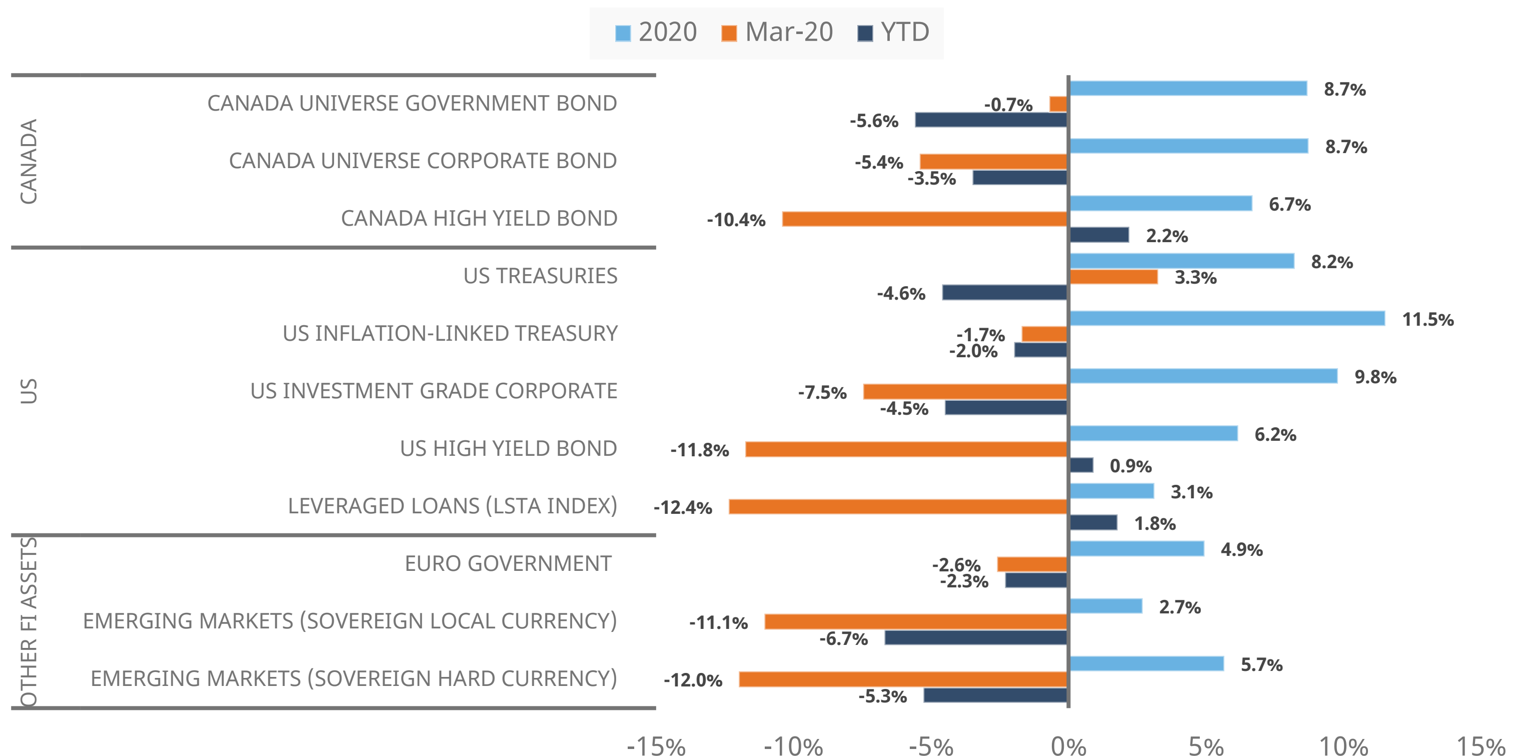
Duration & Curve positioning

- The global debt burden has increased rapidly during the past year and thereby offers some limits to the feel-good environment of stronger growth and higher inflation. Pain will be felt in the most indebted & interest rate sensitive areas of the economy if the rise happens to fast and/or too far. This leads us to having an underweight position in overall duration throughout our portfolios; with a significant part of that underweight in the 10-20-year part of the curve.

- We remain positive on Chinese Rates and have that view expressed in many of our funds. The relative interest rate advantage, significantly positive real yields, stable currency and (*comparatively*) conservative central banks provide us with confidence in our position. While flows have been steadily going in to the Chinese Bond market, we still believe that the global investment community is structurally underweight -> resulting in continuous flow which should further support FX and bonds. Index inclusions and weight increased are set to continue.

- TIPS continued to perform well on a relative basis vs. nominals. 10-year breakevens widened by 40bps and thereby dramatically outperforming nominals. In absolute terms TIPS did not fare that well. The high duration of TIPS paired with the violent 80bps move in US 10yr bonds also affected inflation linked bonds. Interestingly – the curve of the breakevens has flattened, with shorter term breakevens rising more than at the long end of the curve. The market is expressing the view that inflation will rise in the near term, but that the FED will be able to control those higher prices. While we do not expect runaway inflation we have a healthy dose of skepsis. Going forward, we still like to hold TIPS as we not only expect broadly higher yields in the quarters ahead, but also see some inflationary pressures building in the US economy. We expect inflation to play a dominant role going forward in terms of its importance to global rates and risk assets and believe that more upward pressures will be with us in the next few months.

Mackenzie Unconstrained Fixed Income Fund



- EM debt performed poorly in Q1 2021. EM hard currency debt mainly due to its high duration and the lack of any spread compression – the spread of the broad market stayed at 350 bps with EM hard currency debt moving higher in yields by the exact amount that US treasuries did. EM local debt was hit on both the FX and rates side. EM asset in general do not like the strength of the USD and rising US rates – that is primarily due to EM's foreign currency debt becoming more expensive, which in turn makes the country less creditworthy (creating a negative feedback-loop). Much of the rate/FX move in the US was due to US-exceptionalism on vaccine roll-out, re-opening, fiscal thereby amplifying the effect. On the flipside – the overall macro-environment is generally supportive for EM (loose monetary policy, commodity boom, fiscal spending, global trade rebound). The rates & USD story dominated EM markets and resulted in a significant re-positioning and some aggressive price action.

- US-exceptionalism seems close to its peak as Europe and other major nations are gaining momentum in the vaccine roll-out and current lockdowns will likely be removed in the next few months – providing a relative growth outperformance for those regions. EM fundamentals have generally improved, so have valuations and positioning. We remain positive on EM assets.

Investment Grade

- The first quarter of 2021 was marked by continued optimism on two fronts: the fight against the coronavirus and increased expectations south of the border for substantial fiscal support. Democratic wins in Senate runoff contests in Georgia gave the Democrats effective control of the Senate to go along with the White House and the House of Representatives. The immediate effect of this was to allow the administration's US$1.9tn fiscal support package to pass. Prior to their Senate success, estimates for this fiscal package ranged from US$600mm-$900mm. The United States vaccination program made substantial progress during the quarter, eventually accomplishing more than three million vaccines per day and allowing swathes of the economy to begin to reopen.

- Unsurprisingly the market reaction to the fiscal support package was quick and strong. 10y US yields rose from 0.91% to 1.74% during the quarter, while Canadian 10y yields rose in line, from 0.72% to 1.56%. Inflation expectation continued to rise on both sides of the border with US 10y breakeven rates rising 36.5bps and Canadian 10y breakeven rates rising 38bps. As a result, the US Investment grade bond index (source: Bloomberg Barclays US Aggregate Total Return Index) returned -3.37% while the Canadian investment grade bond index returned -5.03% for the quarter.

- Gross investment grade bond supply in the U.S. during Q1/2021 decreased by about 8.5% to US$ 456 billion, from an exceptional Q1/2020 with record volume. Nevertheless, Q1/2021 supply is a heavy-supply quarter historically. In Canada, gross supply in Q1/2021 was about 19% higher than that during the same period in 2020. Rising yields in the earlier part of the quarter prompted more companies to bring issuances be market to lock in lower borrowing rates.

Mackenzie Floating Rate Income Fund

- During the height of the Covid-19 crisis, the Bank of Canada put in place provincial and corporate bond purchase programmes to support the functioning of the financial markets. In light of the improving economy, decreasing unemployment, increasing vaccination of the population and the continuous pledge by the Federal Government to provide additional stimulus, the Bank of Canada decided that these programmes are no longer be required. The change removes a supporting factor for provincial bonds in the 10-year and below term. As such, we look to the out-performance of the long provincial bonds relative to their 10-year counterpart.

High Yield Bond Market

- The high yield market returned +0.90% in the first quarter of 2021, outperforming most other areas of fixed income that were more significantly impacted by the rising rate environment.The economic recovery that appears to be taking hold continues to support the valuations that we currently see in the high yield market.

- Over the past quarter, the US 10-year bond broke out over 1% for the first time since March 2020, as the yield rose from 0.92% to 1.74%. The sharp rise in yields were largely fueled by both the expected economic rebound as the economy re-opens, as well as expectations of rising inflation due to the unprecedented monetary and fiscal policy actions. Rising rates had a disproportionately negative impact on the higher quality BB-segment of the high yield universe with lower yields and thus less cushion from rising rates, resulting in negative (-0.21%) returns in the quarter. Losses in the BB-segment were more than offset by gains in the lower quality segment, as the reopening theme supported the compression trade in credit spreads and drove the B and CCC-segments to +1.18% and +5.2% returns respectively. The high yield market now yields a record low 4.27% YTW and 4.92% YTM, but the 336 spread over treasuries still looks attractive in this low yield environment. The overall quality of the issuers in the index is higher than at any other time in history with a record 54% rated BB. The high yield primary market experienced a record $158.6 billion of new issuance in Q1 '21, providing liquidity and refinancing opportunities for companies to extend out maturities at attractive yield levels.

- Credit fundamentals continue to improve as the economy gradually recovers with businesses reopening and jobs returning, and the vaccine rollout should support stronger economic growth and a material rebound in the coming 12 months. Rising stars far outnumbered fallen angels during the quarter, as more companies were upgraded to investment grade as a result of improved fundamentals, providing a strong technical to the market as result of a lower supply of outstanding high yield bonds. This a sharp contrast to the significant amount of fallen angels from investment grade to high yield that the market experienced in 2020. The high yield default rate increased to a peak of 6.5% in 2020, well below the typical double-digit rate seen in recessionary environments. The default rate is already on a downward trajectory, as Q1'21 saw only 5 defaults for a total of $3.2 billion, representing the lowest default total for a quarter since Q3'18.

- In this low yield environment and almost $14 trillion of global bonds with negative yields, we still see some value in the high yield market. We believe that the 336-basis point spread presents and adequate buffer over treasury yields, and an opportunity to collect an attractive carry yield in this low yield environment. We expect credit selection will grow in importance through the year and an increased focus on corporate earnings and fundamentals, considering the record low yield levels seen in the CCC market and certain cyclical sectors. Given the uncertainties that continue to loom over the market for; vaccine effectiveness for variants, pace of economic recovery, size of fiscal stimulus/infrastructures packages, and potential for government bond yields to continue higher, we do expect to see higher levels of volatility that we hope to be able to capitalize on in our mandates.

Leveraged loans

- What a difference one year makes! Last year we were writing on the big selloff in leveraged loans and the extreme volatility from very sharp drops in mid March to very strong rebounds in late March and April. A year later, we are back to "normal" business amid record primary issuance and relatively low volatility. The leveraged loan market set a record for new issuance in Q1 2021, at $181 bn, surpassing the previous record of $171 bn in Q1 of 2017. However, refinancings accounted for nearly half of this record, resulting in a surge of loan repayments and repricing accounting to roughly 20% of all outstanding loans in the market for the quarter.

- In terms of market performance, we entered Q1 2021 with roll outs of vaccination programs globally, continued monetary and fiscal stimulus and varying degrees of economic reopenings. Stocks continued to hit records and credit performed well despite some on-and-off volatility in the high yield market. Leveraged loans returned +1.78% in Q1, compared to 0.90% for HY bonds (BAML HY Master). This was a rather healthy return compared to IG bonds at -4.49% (BAML HG Corp), and -7.10% for 10 yr US Treasuries. We note that loan returns were +1.19% in Jan and +0.59% in February and 0% in March. The wave of repricings coupled with record primary issuance contributed to a weak secondary loan market in March. Nonetheless, the LTM total return rate was +20.71%.

Mackenzie Floating Rate Income Fund

- The average loan price was 97.5 on March 31st, up 1 ¼ points from Dec 31, 2020 levels and also up ¾ point from pre-covid levels (year-end 2019). However, loans priced above par in March 2021 were only 10.6% of the market versus 12.5% in Dec 2020 and 53% in Dec 2019. And loans priced between 98 and par were 71.6% of the market in March 2021, versus 61.6% in Dec 2020. YTM was 4.39% on March 31 2021 with a spread of 414 over Libor, compared to YTM of 10.09% and 818 bps spread in March 2020.

- Continuing a trend since June 2020, higher rated loans actually underperformed again in Q1 2021. BBB loans had a total return of +0.70% in Q1 (and -0.17% in March). BB loans provided +0.8% in Q1 and -0.27% in March. CCC loans, however, outperformed and recorded a +6.3% total return in Q1 and +0.83% in March, reflecting investors' search for price upside and managers' focus on yieldy loans. Worth noting that CCC loans have now rallied for 12 consecutive months providing a total return of 44% over the LTM period. Another indication of market's search for yield is total return for second lien loans which returned +5.1% in Q1 and +1.45% in March.

- Retail flows into the loan asset class finally turned positive, reflecting investor fears of rising market yields. Except for a small outflow ($10 mil) reported in the first week of the year, flows were positive for the next 15 weeks in a row, totaling a net $10 bn in Q1. As a reminder, a whopping $19 bn left the asset class in 2020, in addition to the $28 bn in outflows in 2019. With $40 bn in new US CLOs priced in Q1 2021, the CLO market had its best Q1 since the 2008 financial crisis, driven by a combination of strong leveraged loan primary issuance, falling liability costs, attractive relative value pool arbitrage, and fresh supply from seasoned and smaller managers after a difficult 2020.

- New issue cannibalization from loans into high yield bonds was a dominant theme in the middle of 2020 (Q2 and a good part of Q3). Dozens of borrowers had opted to issue debt in the form of senior secured notes taking advantage of record low coupons in the high yield market and shunning away from a primary loan market that did not thaw till Q3. As a result, the high yield market saw record volumes of issuance as borrowers raised capital to bolster liquidity. Very strong issuance activity in the HY market continued in Q1 2021 but not at the expense of the loan market. The loan market actually grew in size to a record US$1.208 trillion the end of March 2021 – this compares to US$1.557 trillion for the HY market.

- Finally, back in March the LTM default rate was expected to hit double digit by year-end. Well, that obviously did not happen. Ample market liquidity, government support, corporate forbearance and aggressive cost cutting initiatives, among other things, all played a very critical role in keeping many borrowers afloat without having to recapitalize their capital structures. The loan LTM default rate stood at 3.15% in March 2021, down from 3.83% in Dec 2020. And the percentage of CCC rated loans dropped to 8.3% in March 2021, from 8.5% in Dec 2020. A better assessment of market risk is percent of loans trading below 80 (which is typically the threshold for distressed); these loans dropped to 1.1% of the market, down from 2.2% in Dec 2020 and 24.3% in March 2020. In fact, only 3.8% of loans traded below 90 in March 2021, compared to 63% in March 2020.

- We continue to generally be constructive on credit in 2021. With vaccinations rolling in full force globally, coupled with aggressive and decisive FED and government stimulus for the foreseeable future, we expect Q2, and especially April, to provide above average returns in the loan market. With loans' total return at +3.1% in 2020 which is a below-carry year, and at +1.78% in Q1 2021, we expect a little more recovery in loan prices throughout the second half of 2021 and for total returns to be above carry in 2021 overall.

- As we stated in our last quarterly commentary, we must reiterate that the "low hanging fruit" in the loan market has been picked. To be fair, that also should be said about many other asset classes such as stocks and HY bonds. Nonetheless, we believe there is still value in the leveraged loan market especially relative to other asset classes, for the reasons outlined above. We expect credit selection will grow in importance in the rest of 2021, as investors transition from buying market beta, to an increased focus on corporate earnings and fundamentals – we still have the view that middle market loans will outperform as they did in 2020.

- Vaccinations against Covid-19 is the one thing that matters the most in 2021. It's too early to tell but the world is watching. Secondary to Covid vaccinations is a bigger focus in the US on fiscal stimulus in conjunction with a sustained, very accommodative monetary policy. This macro environment should be supportive for credit especially for leveraged loans.

- Over the next quarter we expect the same general themes to persist, albeit with periods of consolidation. We expect continued vaccination progress and the reopening of the economy to be positives for the economy, and accompanied by continued improvements in both employment and consumer spending. This, along with continued support from the government and the Bank of Canada, is likely to support risk markets. We do not expect material widening of investment grade credit spreads, although we are cognizant of the fact that risk assets are somewhat 'fully valued'.

- With the U.S. Fed and the Bank of Canada keeping the short end of the curve pegged at historically low yields, the market saw dramatic steepening in the yield curve, with the 10-year term sitting at the steepest point against the 2-year term since 2015. Still rates remain low by historical standards, and we remain short duration across the funds in anticipation of continued fiscal stimulus, as well as, eventually, central bank tapering of their QE purchases. With rates still at all-time lows, the risks of holding short end debt remain asymmetric and we continue to prefer floating rate debt in this part of the curve.

Mackenzie Unconstrained Fixed Income Fund

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