PURPOSE INVESTMENTS

PURPOSE STRATEGIC YIELD FUND – Q4 2018 COMMENTARY

QUICK FACTS

SERIES F	LGQ802
MGMT FEE	0.80%
SERIES B (FE)	LGQ800
MGMT FEE	1.55%
INCEPTION DATE	August 19, 2011
CURRENT YIELD*	5.8%

*Series F, as at December 31, 2018

SANDY LIANG, CFA

Sandy Liang has more than 25 years of experience managing credit investments. He spent 17 years in Wall Street, leading fixed income for Cobalt Capital Management, and as a Senior Managing Director at Bear, Stearns & Co., where he was voted to Institutional Investor Magazine's All-America Fixed Income Research Team for seven consecutive years.

Fund Performance

In 2018, virtually every risk asset category generated negative returns to varying degrees, with higher interest rates the culprit in the first half of the year and downshifting economic growth wreaking havoc in the fourth quarter. Until the extremely volatile fourth quarter, the Fund had been generating positive returns YTD, but it ended the year with a slight loss.

In the fourth quarter, Purpose Strategic Yield Fund returned -4.9% compared with -4.8% return for the iShares US High Yield Bond Index ETF (XHY, CAD-Hedged). For the full year 2018, the Fund returned -1.2% versus -3.6% for XHY. Over the past three years the Fund has returned 7.6% on an annualized basis compared with 5.0% for XHY.

The top corporate bond return contributors to the Fund in the fourth quarter were Largo Resources Ltd. 9.25% of 2021, MEG Energy 6.375% of 2023 and Tesla, Inc. 5.375% of 2023. During the quarter, the top absolute contributor to return was a long position in US Treasury bonds through the iShares 20+ Year Treasury Bond ETF (TLT), as excess cash was deployed in long duration government debt due to its negative correlation with risk assets. The largest detractors to return were CURO Financial Technologies Corp 8.25% of 2025, Enova International, Inc. 8.5% of 2024 and Vine Resources Inc. 9.25% of 2023.

The Fund ended the year with an internal yield in the 8% area, higher than the range of 6% to 7% throughout most of the year.

Fund Positioning and Outlook

The Fund has exited the position in MEG Energy bonds ahead of an imminent shareholder vote regarding its hostile takeover by Husky Energy. While the bonds will trade higher if the vote is successful, we view the risk/reward in the bonds as less favourable now. While bonds of CURO Financial and Enova, non-prime consumer lenders in the US, were significant detractors in 4Q, we view the businesses as positioned for continued earnings growth and resumption of equity value creation.

Looking ahead to 2019, we think the economic and financial market environment is favourable for corporate debt. We view the recent volatility in debt and equity markets as an overshoot caused by lower-growth concerns for 2019 and 2020, with financial markets discounting a significant economic slowdown. The market's view is inconsistent with that of the Federal Reserve, which sees low to mid-2% growth in 2019 with no recession in sight. Based on a number of indicators we follow, we do expect slower US economic growth in the US, consistent with the Fed in the 2%-2.5% area. This would not be in recession territory, but rather a normal slowdown within the ebbs and flows of the economic cycle. Combined with extremely low interest rates and continued moderate inflation, this spells out an environment which remains accommodative for corporate credit and should facilitate continuation of low default rates. To wit, in the fourth quarter of 2018, high yield credit spreads widened by 200 basis points to end at 573 basis points and a yield of 8.23%. That marks the highest yield since April 2016, which was near the beginning of more than two years of strong returns in the US high yield debt market.

While our larger picture view is that the bear market in Treasury bonds began in mid-2016, in the near term there has been respite from higher bond yields due to inflation taking a pause (helped along by lower oil prices). The increased supply of US government debt due to large budget deficits will likely be absorbed by households given recent financial market volatility. As financial markets get attuned to the lower growth environment, we expect a resumption of higher bond yields in the coming year. Historically, high yield corporate debt has outperformed investment grade corporate debt in periods of rising rates. We expect Fund positioning to be consistent with this theme.

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Purpose Strategic Yield Fund	1 month	3 month	6 month	YTD	1 year	3 year	5 year	Since inception
Series F	-1.73%	-4.90%	-3.64%	-1.21%	-1.21%	7.57%	3.70%	5.80%
Series B	-1.80%	-5.10%	-4.05%	-2.03%	-2.03%	6.68%	2.84%	4.90%

All performance as at December 31, 2018. Source: Bloomberg

Redwood Asset Management Inc. amalgamated with its parent company, Purpose Investments Inc,. on March 31, 2018. Purpose is a different kind of investment company, with an unrelenting focus on client-centric innovation. We offer a range of managed and quantitative investment products, with each product designed to have a clear purpose – to meet a specific goal in building resilient portfolios for our clients. Purpose Investments is a division of Purpose Financial, an independent technology-driven financial services company.

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