CAPSTONE FIXED INCOME POOL

Q3 Commentary

CAPSTONE
ASSET MANAGEMENT™

SEPTEMBER 30, 2018

AT A GLANCE

- Blend of traditional and non-traditional fixed income strategies
- Globally diversified
- Weekly liquidity
- Low correlation to bond market
- $41MM AUM

MARKET & POOL UPDATE

In July, the Bank of Canada (BOC) increased interest rates once again to 1.5%, with current inflation hitting BOC targets. Combined with the most recent progress on NAFTA at quarter-end, additional rate increases this year appear likely. Since Canadian interest rate changes remain very data dependent, the consensus on a rate increase could change at any point. The next meeting of the BOC is scheduled for October 24.

Steady economic growth, primarily led by strong consumption and labour markets, has prompted the U.S. to once again raise interest rates over this past quarter to 2.25%. The Federal Reserve (Fed) has remained committed to a tightening agenda and additional hikes in the future are expected. The next meeting of the Fed is scheduled for November 8.

On a portfolio level, changes in interest rates continue to cause many traditional fixed income investments to underperform for Canadians. The XBB (iShares Canadian Universe Bond Index ETF), a good proxy for the Canadian traditional bond market, only returned 1.58% over the past year. Investors exposed to a lower risk, traditional fixed income portfolio have not even been able to protect their investments from inflation, which has been near 3% over the summer. The underperformance of traditional fixed income is likely to persist if interest rates continue to move up.

At Capstone, we have addressed this problem by supplementing our Capstone Fixed Income Pool with non-traditional fixed income options. These include, to name a few, low-risk (bank grade) construction mortgages, private debt instruments, factoring, infrastructure investments and, most recently, a global real estate fund. Since these non-traditional investments are uncorrelated to interest rate fluctuations, they have done a good job of providing fixed income exposure with a stable return of 2.93% over the past year.

The Capstone Fixed Income Pool continues to target a rate of return of 4% for 2018, but it is reasonable to expect the traditional side of the portfolio to experience some volatility while an environment of increasing interest rates persists. This volatility could detract from performance over the short-term and pull the annual return into the 3% range. However, we are working hard to mitigate these risks by supplementing the portfolio with stable interest producing investments that are less correlated to interest rate changes.

PERFORMANCE (Net of Fees)

Performance figures are those of Class F units as of September 30, 2018. Performance is annualized for periods longer than one year.

1 MO.	*3 MO.*	*6 MO.*	*1 YR.*	*3 YR.*	*INCEPTION**
-0.03%	0.44%	1.21%	2.93%	3.38%	3.28%

**Launched December 6, 2013*