AGF Canadian Bond Fund

FUND COMMENTARY FOURTH QUARTER 2015 **FOR ADVISOR USE WITH INVESTORS**

FUND FACTS

FUND CATEGORY:	BENCHMARK INDEX:	DATE OF INCEPTION:	INVESTMENT STYLE:	PORTFOLIO MANAGER:
Canadian bond	FTSE TMX Canada Universe Bond Index	August 1962	Top-down fundamental research	AGF Investments Inc. David Stonehouse, MBA, CFA

Market overview

The Canadian economy continued to struggle during the quarter as oil prices moved lower due to increased production and inventories and as OPEC elected not to cut output. As a result, inflation and bond yields in Canada continued to decline. Economic activity in Canada remained weak, with data released during the quarter showing that the economy grew a mere 0.1% in August, followed by a 0.5% contraction in September and no change in October. The Bank of Canada left rates unchanged during the quarter, stating that the domestic economy was adjusting as expected to low oil prices and other global pressures.

The U.S. economy continued to slow during the quarter. The manufacturing sector entered contraction territory, with the ISM Manufacturing Index dipping below 50 in November. GDP growth released in December for the third quarter showed that the economy expanded at a 2.0% rate as a result of strong consumer and business spending. However, this was lower than the 3.9% growth posted in the second quarter, due to a buildup in inventories, a deceleration in imports against a stronger U.S. dollar, low global commodity prices and a slower global growth environment. The highly anticipated hike by the U.S. Federal Reserve Board (Fed) finally came to fruition, with the Fed raising its benchmark overnight interest rate by 25 basis points in December.

The European Central Bank (ECB) extended its €60 billion a month asset purchase program by six months, until March 2017, and also cut its key deposit rate by 10 basis points to -0.3% as the eurozone continued to face deflationary pressures in a tepid growth environment. Manufacturing activity remained in expansionary territory with a final Markit Manufacturing PMI reading of 53.2 in December compared to a final reading of 52.8 in November.

China continued to face a slowdown in growth with manufacturing decelerating for the sixth consecutive month in November. In response, the Chinese government implemented a number of policy measures, including 25 basis point cuts in the benchmark one-year lending and deposit rates to 4.35% and 1.50%, respectively. Fiscal stimulus measures also increased with government spending increasing to 17.6% year-over-year in November. The International Monetary Fund added the renminbi to the Special Drawing Rights (SDR) basket at an 11% weight, higher than the Japanese yen and the British Pound.

In Canada, yields rose in October and November before retracing their upward trend in December as risk aversion increased. High yield bond spreads modestly widened over the period as a result of the risk-off environment in December, which resulted in the asset class underperforming during the quarter.

Fund overview

As at Dec. 31, 2015	3 mo.	1 yr.	3 yr.	5 yr.	10 yr.	PSD*
AGF Canadian Bond Fund (%)	0.0	0.8	1.3	2.4	2.9	7.6
FTSE TMX Canada Universe Bond Index (%)	1.0	3.5	3.6	4.8	5.0	-

Source: AGF Investment Operations.

* Performance start date (PSD): Nov. 30, 1962.

The Fund had flat performance during the quarter, which underperformed the benchmark's return of 1.0%. The Fund's overweight allocation to investment grade corporate bonds slightly detracted as spreads widened in the risk averse environment.

In addition, the Fund's modest out-of-benchmark exposure to high yield bonds also detracted due to spread widening. Partially offsetting these adverse variances was the Fund's overweight allocation to long-term Government of Canada bonds, which performed particularly well in December as yields declined.

Outlook

2015 ended as one of the weakest years for overall capital markets in history, with few major asset categories outperforming inflation. Canadian bonds fared well in the risk averse environment and we expect risk aversion and volatility to continue into the early part of next year.

The significant weakening of the Canadian dollar due to depressed oil prices and accommodative monetary policy, should help to stimulate the economy through increased export activity, though this may take time to filter through. In addition, if oil prices were to stabilize and perhaps even appreciate over the next year or two, the after-effects of the price shock should abate. However, there is a chance that the Bank of Canada will decide to implement further stimulus. Conversely, while the Fed hiked interest rates at its December meeting, we anticipate that future rate hikes will likely be few and far between.

Given anemic growth and the dampening effects of a strong U.S. dollar, we do not anticipate a significant degree of U.S. monetary

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tightening from these levels. As a consequence, in 2016 monetary policies north and south of the border may not deviate as much as many anticipate, and the Canadian dollar's precipitous rate of decline may abate or even reverse for at least a while, particularly if oil prices become more supportive. This would potentially be positive for corporate bonds. Credit markets have been challenged over the past couple of years, but if a recession is avoided, corporate bonds could plausibly deliver gains following last year's spread widening. However, we remain somewhat cautious in the near term.

While we reduced our exposure last year, we continue to maintain a modest overweight to corporate bonds (both investment grade and high yield), which should continue to provide higher yields, more upside potential over the long term, lower interest rate sensitivity, and diversification benefits relative to conventional bonds. We also remain favourably disposed toward select convertible debenture opportunities.

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