AGF Inflation Plus Bond Fund*

FUND COMMENTARY First Quarter 2015

FUND FACTS

FUND CATEGORY:	BENCHMARK INDEX:	DATE OF INCEPTION:	INVESTMENT STYLE:	PORTFOLIO MANAGERS:
Short-term Canadian bond	50% FTSE TMX Canada Short Term Bond Index/50% Barclays Global Inflation-Linked Bond Index (C$ hedged)	April 1984	Top-down fundamental research	AGF Investments Inc. Tom Nakamura, CFA Tristan Sones, CFA

Market overview

The Canadian economy slowed during the first quarter as oil price weakness continued to weigh on economic growth, which resulted in a surprise rate cut by the Bank of Canada in January. The upside to lower oil prices and a weaker Canadian dollar was an improvement in the manufacturing and exporting sectors of the economy, helping to offset weakness in the Energy sector. Labour market conditions remained sluggish, with data showing that employment rose slightly more than 0.5% during 2014, the lowest in five years.

The U.S. economy moderated during the quarter as a decline in energy-related capital expenditures and an appreciating U.S. dollar weighed on growth. A number of temporary factors were at play, including harsh winter conditions in various parts of the country, a West Coast port dispute and auto sector retooling. Industrial production continued to improve as a result of solid demand for motor vehicles and parts, business equipment and technology goods. Consumer spending and confidence were supported by lower gasoline prices, labour market improvement and rising household net worth. Still, data generally fell short of expectations as the quarter progressed. The U.S. Federal Reserve Board (Fed) remained accommodative by appearing less upbeat on cyclical trends but removed the word ‘patience’ in its message on monetary policy, preparing the market for future interest rate hikes.

The European Central Bank (ECB) indicated in January that it would initiate a €60 billion per month asset purchase program in March, which is expected to run until at least September 2016. In combination with the ECB’s efforts, lower oil prices and a weaker euro led to widespread gains among leading European indicators, including PMIs, industrial production, and business and consumer confidence. As a result of declining bond yields during the quarter, inflation-linked bonds performed well, particularly in Canada where durations are longer and inflation expectations rose modestly.

Fund overview

As at Mar. 31, 2015	3 mo.	1 yr.	3 yr.	5 yr.	10 yr.	PSD**
AGF Inflation Plus Bond Fund* (%) (net of fees)	1.3	1.8	0.7	1.8	2.4	4.8
Benchmark (%)	2.6	7.4	4.1	4.9	4.8	-

Source: AGF Investment Operations.

** Performance start date (PSD): May 31, 1989.

Long-term bonds outperformed short-term bonds as yields declined during the quarter. This resulted in global inflation-linked bonds (ILBs) generally outperforming short-term fixed-coupon bonds as a result of their longer average durations, though this differed by country. As a result, the Fund’s underweight allocation to ILBs detracted during the quarter and over the longer term given the decline in bond yields. The Fund maintained an average exposure of approximately 33% to ILBs, while the benchmark has a neutral weight of 50%.

From a regional perspective, the Fund’s overweight allocation to Canadian real return bonds contributed positively to performance as Canada outperformed most of the countries within the Barclays Global Inflation-Linked Bond Index during the quarter as a result of their longer average duration combined with a modest rise in inflation expectations. An underweight to the United States positively contributed to returns as it underperformed.

We decreased our exposure to floating-rate notes during the quarter as the Bank of Canada cut rates in January. The Fund’s average exposure of approximately 46% detracted from performance as the main reference rate for Canadian floating-rate notes (CDOR, or Canadian Dealer Offered Rate) declined, particularly in January as the Bank of Canada cut interest rates.

Outlook

The market continues to digest incoming economic data in order to ascertain the timing of the initial Fed rate hike. Recent weakness in economic data supports our long-standing belief that policy rates and bond yields, in general, will remain lower for longer than market participants expect. In the short term, while overall momentum in U.S. industrial activity and business spending has slowed recently, the second quarter may show improvement as some of the temporary factors that weighed on growth in the first quarter are expected to fade.

Economic growth in Canada is also expected to show modest improvement in the second quarter, with the weaker Canadian dollar continuing to support the positive momentum in the export sector, and energy prices stabilizing. Headline inflation has declined alongside lower oil prices and soft wage growth, and is expected to remain muted in the intermediate term. Consequently, we expect to maintain an underweight to ILBs.

What are you doing after work?®

In this environment, we anticipate that bond yields will continue to stay in a relatively low range. However, this does not preclude a modest rise in rates, which we anticipate by year-end.

For this reason, we expect to maintain our exposure to floating-rate notes but not to add materially to it.

* On April 19, 2010, the Fund changed its investment objective to provide monthly income with safety of capital. It invests primarily in investment-grade bonds of Canadian federal and provincial governments, inflation-indexed bonds and floating-rate securities and may invest in dividend-paying shares of established Canadian companies and other financial securities.

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