AGF Canadian Asset Allocation Fund

FUND COMMENTARY FIRST QUARTER 2017 | **FOR ADVISOR USE WITH INVESTORS**

FUND FACTS

FUND CATEGORY:	BENCHMARK INDEX:	DATE OF INCEPTION:	INVESTMENT STYLE:	PORTFOLIO MANAGER:
Canadian equity balanced	**60% S&P/TSX Composite Total Return Index, 40% FTSE TMX Canada Universe Bond Index	July 1931 MANAGER START DATE: August 2015	Top-down asset allocation Bottom-up stock selection	AGF Investments Inc. AGF Asset Allocation Committee

Market overview

During the first quarter of 2017, global equities continued to move higher, continuing a rally that followed the U.S. election in early November. However, leadership in the market shifted, as the reflation trade that followed the election of Donald Trump to the U.S. Presidency in late 2016 waned, with financials and cyclical leadership giving way to secular growth sectors. As such, portfolios with growth investment styles performed relatively better than in late 2016 when growth severely underperformed value.

From a macroeconomic perspective, economic data remained supportive and in some cases, saw acceleration. In the U.S., non-farm payrolls exceeded market expectations for the first two months of 2017, averaging 231K gains per month, which was well above consensus, as well as the pace in 2016. Meanwhile, the ISM Manufacturing Index continued to accelerate well into expansion territory, hitting a high of 57.7 in February before settling at 57.2 in March. Similarly, the services sector remained robust, with the ISM Non-Manufacturing PMI at 57.6, signalling strong expansion conditions. In response to the strong macroeconomic data, the U.S. Federal Reserve raised the federal funds rate for a third time this cycle in March, while telegraphing more rate hikes to come in 2017 and also mentioning that any future hikes would be “gradual”.

In Canada, equity markets continued their move higher as macroeconomic data remained supportive. Data released during the quarter showed that the Canadian economy grew faster than expected in January, up 0.6% on a monthly sequential basis and 2.3% on a year over year basis. In fact, seven out of the past eight months have reported monthly GDP gains of 0.3% or better, which is nearly double the 15-year average of 0.17%. Growth was broad-based, with 15 out of 20 major industries reporting gains, led by manufacturing, resources, and wholesale trade. The strong GDP print, in addition to other improving Canadian data, is expected to result in upwardly revised growth forecasts, though the Bank of Canada remains dovish and is widely expected to keep rates on hold throughout the year.

After a sustained rise in bond yields during the second half of 2016 due to reflation trends, rising economic activity and optimism following the U.S. election, yields in the first calendar quarter of 2017 remained in a tight range. Bond yields generally fell more in Canada than in the United States, resulting in Canadian bond outperformance during the quarter. Canadian bond yields with maturities of six years and longer declined, while most yields in the short-term portion of the curve (maturities up to five years) saw little to no change. However, three-month yields rose about 10 basis points as market participants priced out an interest rate cut by the Bank of Canada as economic growth improved and the Fed’s rate hike in March. The long-term portion of the curve outperformed during the quarter, supported by a modest decline in bond yields. Investment grade corporate bonds outperformed government bonds due to tightening spreads, while high yield bonds continued to perform strongly due to spread tightening and higher coupon income. Convertible securities significantly outperformed on the back of a strong rise in equities.

Fund overview

As at March 31, 2017	3 mo.	YTD	1 yr.	3 yr.	5 yr.	10 yr.	PSD*
AGF Canadian Asset Allocation Fund (%) (net of fees)	1.9	1.9	9.0	3.9	6.8	3.2	4.9
Benchmark (%)**	2.0	2.0	11.6	5.4	6.3	5.1	7.0

Source: AGF Investment Operations

* Performance start date (PSD): December 17, 2001

For the quarter ended March 31, 2016, the portfolio marginally underperformed the benchmark 60% S&P/TSX Composite Index / 40% FTSE TMX Canada Universe Bond Index.

During the period, the Fund maintained out-of-benchmark exposure to global equities through allocation to AGF Global Equity Fund and AGF American Growth Class, which contributed to performance, as global equities generally outperformed Canadian equities during the period.

An underweight exposure to fixed income, as compared to the benchmark, also contributed to performance, as fixed income remained in a tight range following a material rise in yields during the prior period which was caused by reflation trends, rising economic activity and optimism following the U.S. election.

The performance of the underlying funds generally contributed, as AGF Dividend Income Fund, AGF American Growth Class and AGF Fixed Income Plus all outperformed their respective benchmarks. AGF Global Equity Fund underperformed its respective benchmark, though earned positive absolute returns.

A small allocation to cash caused the Fund’s marginal underperformance in comparison to the benchmark, as both equity and fixed income markets were generally positive during the period.

What are you doing after work?®

Outlook

Within equities, we expect to maintain the Fund's out-of-benchmark allocation beyond domestic markets, with exposure to to the U.S. and other global markets.

Looking ahead, we continue to believe Canadian equities are well positioned as economic growth is accelerating, the oil market continues to shift towards a balancing of supply and demand, and overall valuation multiples are in line with historical averages. Our belief is that the market will continue to reward pro-growth, pro-cyclical stocks, and Canada has one of the largest sector weightings to these groups of any index in the world.

In the U.S., we remain bullish overall, yet with caution as we monitor a building of near-term risks, which may result in short-term volatility. Given the sizable rally that we have already experienced, a correction will inevitably emerge at some point, and may be triggered by factors such as additional rate hikes, delayed implementation of legislative initiatives, policy mishaps including trade protectionism, volatility caused by European election results or simply the end of the most seasonally favourable time for equities.

We are constructive on other developed global markets as well, given a supportive economic backdrop and broadly accommodative central bank policies. The acceleration in economic growth has contributed to upward revisions in earnings estimates, which is positive for equities. Central banks remain accommodative, providing further support for growth.

Our outlook for fixed income is currently mildly positive as economic growth momentum continues, partially offset by the somewhat elevated valuations of riskier asset classes. Consequently, we prefer investment-grade corporate bonds over government bonds, which may struggle with rising yields. We are neutral on high yield bonds: while defaults should not be significant in the absence of a recession and corporate fundamentals have started to improve, we are in the late stage of the cycle in our view, and valuations are closer to the high end of their historical range. We believe that equities, and hence convertible bonds, should benefit from monetary and fiscal stimulus this year as economic activity improves.

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