AGF Diversified Income Fund

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

FUND FACTS

FUND CATEGORY:	BENCHMARK INDEX*:	DATE OF INCEPTION:	INVESTMENT STYLE:	PORTFOLIO MANAGER:
Global balanced	50% FTSE TMX Canada Universe Bond Index / 25% Barclays Capital U.S. Corporate High-Yield Index (local) / 10% S&P/TSX Composite Index / 15% MSCI All Country World Total Return Index (local)	March 2003	Equity: GARP Fixed income: Top-down fundamental approach with a bottom-up approach to corporate bond selection.	AGF Investments Inc. David Stonehouse, MBA, CFA

Market overview

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. Data released during the quarter showed that U.S. GDP growth expanded at a 2.1% annual pace during the fourth quarter, following a higher-than-expected 3.5% during the third quarter. The U.S. Federal Reserve raised interest rates by 25 basis points at its March meeting, taking its target range to 0.75% - 1.00%, and continued to emphasize that the path for future rate hikes will be “gradual”.

In Canada, the economy continued to grow at a solid pace, rising 2.3% year over year in January. The labour market continued to improve as did manufacturing activity, with the Markit Canadian Manufacturing PMI rising from 51.8 in December to 54.7 in February. Headline inflation rose to a 2.0% annual pace in February, while core prices increased modestly to a 1.7% annual pace in February. Encouragingly, retail sales jumped 2.2% in January, the largest increase since March 2010. Sales were broad-based, rising across 10 of 11 subsectors and led by new vehicle sales.

The UK formally commenced the process of leaving the European Union as Prime Minister Theresa May invoked Article 50 at the end of March 2017, which started a two year negotiating process. Elections in the Netherlands saw a significant defeat for far-right candidate Geert Wilders in March. The European Central Bank (ECB) kept rates unchanged at its meeting in March despite improving economic data, including the highest inflation in four years. The Eurozone Manufacturing PMI and Eurozone Services PMI improved to 55.4 and 55.5, respectively, in February, from December’s levels of 54.9 and 53.7, respectively.

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 following improving economic growth and the Fed’s surprise 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 tightening of spreads and higher coupon income. Convertible securities significantly outperformed on the back of a strong rise in equities.

Canadian equities appreciated during the quarter, although significantly underperformed U.S. and global equities. The Energy sector weighed on Canadian equities as oil prices declined, while Health Care also detracted from Canadian equity returns. In the U.S., the Information Technology and Consumer Discretionary sectors led U.S. equities significantly higher during the quarter, in U.S. dollar terms.

Fund overview

As at Mar. 31, 2017	3 mo.	1 yr.	3 yr.	5 yr.	10 yr.	PSD**
AGF Diversified Income Fund (%)	2.4	5.9	3.0	5.1	4.3	9.4
Benchmark (%)	2.6	9.0	5.1	5.7	5.0	4.4

Source: AGF Investment Operations.

**Performance start date (PSD): March 31, 2003.

The Fund outperformed its benchmark’s during the quarter.

The Fund’s fixed income positioning contributed positively to returns. An overweight to investment grade corporate bonds contributed positively due to their outperformance as credit spreads tightened. The Fund’s overweight to U.S. and Canadian high-yield bonds contributed positively as credit spreads tightened and exposure to convertible bonds due to the outperformance of equity markets.

The Fund’s equity exposure detracted from returns relative to the benchmark. Security selection detracted, while sector allocation contributed positively. Selection within Industrials, Materials, Consumer Staples and Health Care detracted from performance, while selection within Real Estate, Consumer Discretionary, Telecommunication Services and Energy contributed positively.

Outlook

In Canada, economic growth continues to rebound from the sluggishness of 2015 and early 2016 as energy prices recover and household consumption remains robust. In addition, should U.S. growth strengthen, exports in Canada could benefit. However, the record level of household debt, coupled with the implementation of several housing policy measures, may pose challenges to consumer spending (almost 60% of GDP).

The U.S. Federal Reserve is likely to raise policy rates further in the coming months, albeit at a gradual pace. Furthermore, we anticipate that the European Central Bank will announce a reduction in or cessation of asset purchases later this year. We expect that the Bank of Canada will remain on hold this year as exports remain subdued and inflation and unemployment trends remain stable.

The major political risks that commenced in 2016 have been well telegraphed, and may not have as great a capacity to surprise in 2017. Still, markets were negatively impacted by the Trump administration's failed health care bill. Focus will now be on the current administration's ability to pass through pro-growth policies, such as tax reforms. Two major events to watch are elections in France starting in April, followed by German elections in September.

In the near term, we expect bond yields will likely remain range-bound should economic data remain healthy and geopolitical risk remain stable. However, yields are likely to move higher if global growth and inflation prospects become more favourable later this year. However, rates are unlikely to move substantially higher as we believe that significantly higher rates would likely start crimping economic activity.

Our outlook 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 if yields increase. 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.

** On April 2, 2012, the benchmark changed from a blended index of 50% FTSE TMX Canada Universe Bond Index / 25% Barclays Capital U.S. Corporate High-Yield Index / 15% S&P/TSX Composite Index / 10% MSCI World REIT Index Net to a blended index of 50% FTSE TMX Canada Universe Bond Index / 12.5% Barclays Capital U.S. Corporate High-Yield Index (local) / 12.5% FTSE TMX Canada High-Yield Bond Index / 15% S&P/TSX Composite Index / 10% MSCI World REIT Index Net. Then on June 1, 2013, the benchmark changed to a blended index of 50% FTSE TMX Canada Universe Bond Index / 20% Barclays Capital U.S. Corporate High-Yield Index (local) / 5% FTSE TMX Canada High-Yield Bond Index / 15% S&P/TSX Composite Index / 5% MSCI World REIT Index Net / 5% MSCI All Country World Total Return Index (local). Then on June 1, 2016, the benchmark changed to a blended index of 50% FTSE TMX Canada Universe Bond Index / 25% Barclays Capital U.S. Corporate High-Yield Index (local) / 10% S&P/TSX Composite Index / 15% MSCI All Country World Total Return Index (local). In all cases, the benchmark change was applied from that date forward. In all cases, the benchmark change was applied from that date forward. On August 12, 2009, unitholders approved a change in the investment objective increasing the portfolio's diversification to include high-yielding and dividend-paying securities. AGF Investments Inc. replaced Acuity Investment Management Inc. as portfolio manager, effective April 17, 2015. Commentary and data sourced from Bloomberg, Reuters and company reports. The commentaries contained herein are provided as a general source of information based on information available as of March 31, 2017 and should not be considered as personal investment advice or an offer or solicitation to buy and/or sell securities. Every effort has been made to ensure accuracy in these commentaries at the time of publication; however, accuracy cannot be guaranteed. Market conditions may change and the manager accepts no responsibility for individual investment decisions arising from the use of or reliance on the information contained herein. References to specific securities are presented to illustrate the application of our investment philosophy only and are not to be considered recommendations by AGF Investments. The specific securities identified and described in this commentary do not represent all of the securities purchased, sold or recommended for the portfolio, and it should not be assumed that investments in the securities identified were or will be profitable. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in share and/or unit value and reinvestment of all dividends and/or distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Mutual funds are not guaranteed; their values change frequently and past performance may not be repeated. The payment of distributions should not be confused with a fund's performance, rate of return or yield. If distributions paid by the fund are greater than the performance of the fund, your original investment will shrink. Distributions paid as a result of capital gains realized by a fund, and income and dividends earned by a fund, are taxable in your hands in the year they are paid. Your adjusted cost base will be reduced by the amount of any returns of capital. If your adjusted cost base falls below zero, you will have to pay capital gains tax on the amount below zero.The information contained herein is designed to provide you with general information related to investment alternatives and strategies and is not intended to be comprehensive investment advice applicable to the circumstances of the individual. We strongly recommend that you consult with a financial advisor prior to making any investment decisions.

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