Mackenzie ETF Portfolios Quarterly Review

March 31, 2019

About Mackenzie ETF Portfolios

Mackenzie ETF Portfolios are Managed Solutions that provide investors with a suite of globally diversified, multi-asset portfolios blending Mackenzie's active, strategic beta and traditional index ETFs with industry-leading portfolio construction and risk management.

Market Overview

Canadian Equity: Equity markets, globally, posted strong returns for the quarter. The S&P/TSX Composite was among the best performing equity indices, up 13.3% for the quarter. All GICS sectors posted positive returns. The Energy sector (+15.6%) was the largest contributor to returns, recovering most of its losses from Q4 2018 as oil prices rebounded from last quarter's sharp declines. Other top performing sectors included the cannabis heavy Health Care sector (+49.1%) and Info Tech (+26.0%). Materials (+8.5%), Consumer Discretionary (+9.8%) and Communication Services (+10%) provided solid returns but lagged the sector average.

US Equity: The S&P 500, seemingly buoyed by the Fed's more cautious approach to rate normalization, rose 13.6% (11.2% CAD) for the quarter. In local currency terms, Info Tech (19.9%), Real Estate (+17.5%) and Industrials (+17.2%) sectors lead performance. Health Care (+6.6%) and Financials (+8.6%) were the only sectors to post less than a 10% return.

International Equity: International equity markets also posted strong returns but generally lagged North American markets during the quarter. The MSCI EAFE Index returned 10.7% in local currency terms (7.7% CAD). Italy (+16.8%) and Hong Kong (+15.9%) were among the best performing markets while Japan (+7.8%) was unable to keep up with the average. The MSCI Emerging Markets Index returned 9.9% (7.6% CAD) with China (+17.9%) contributing significantly to returns. Large EM markets South Korea (6.7%), India (6.3%) and South Africa (4.8%) lagged the index average.

Fixed Income: Bond markets also enjoyed a solid positive quarter as yields fell globally. High yield bonds benefitted most from investors' risk on stance, returning 7.4% in local currencies. For the quarter, Canadian bonds (FTSE TMX Canada Universe Bond Index) rose 3.9% and global bonds (Bloomberg Barclays Global Aggregate Bond Index Hedged to CAD) rose 2.8%.

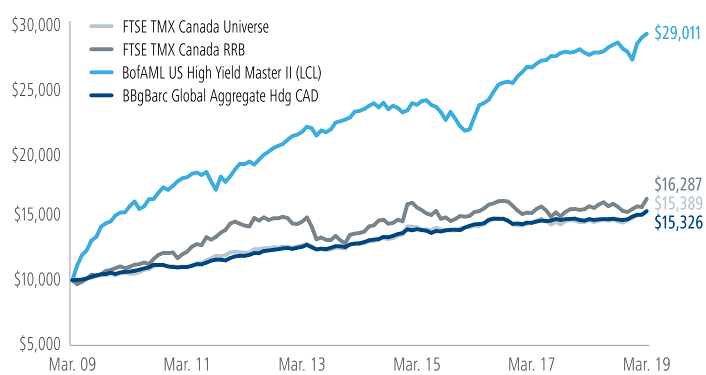
Currency: The Canadian dollar, supported by higher oil prices, had a strong quarter, rising 2.2% against the U.S. dollar, 4.4% against the euro and 3.3% against the yen. There was no change against the British pound.

Fixed Income Markets

	3M	YTD	1Y	3Y	5Y	10Y
FTSE TMX Canada Universe Bond	3.9	3.9	5.3	2.7	3.8	4.4
FTSE TMX Canada Real Return Bond	5.1	5.1	3.7	2.2	3.6	5.0
B of A Merrill Lynch US High Yield Master II (LCL)	7.4	7.4	5.9	8.7	4.7	11.2
BBgBarc Global Aggregate Hdg CAD	2.8	2.8	4.1	2.3	3.6	4.4

Source: Morningstar, March 31, 2019.

Growth of $10,000 (CAD)

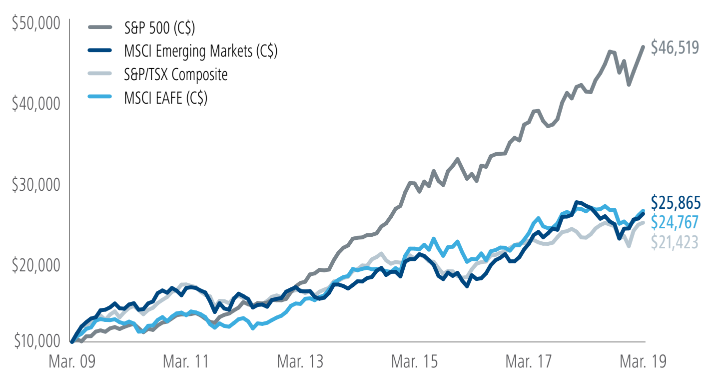


Equity Markets

	3M	YTD	1Y	3Y	5Y	10Y
S&P/TSX Composite	13.3	13.3	8.1	9.3	5.4	9.5
S&P 500 (C$)	11.2	11.2	13.5	14.8	15.2	16.6
MSCI EAFE (C$)	7.7	7.7	0.3	9.0	6.8	10.1
MSCI Emerging Markets (C$)	7.6	7.6	-3.7	12.3	8.1	10.0

Source: Morningstar, March 31, 2019.

Growth of $10,000 (CAD)



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Portfolio Performance - Series F

	3 Month	YTD	1 Year	3 Year	5 Year	10 Year	SI[1]
Mackenzie Conservative Income ETF Portfolio	5.7	5.7	3.9	N/A	N/A	N/A	2.8
Mackenzie Conservative ETF Portfolio	5.9	5.9	3.9	N/A	N/A	N/A	2.3
Mackenzie Balanced ETF Portfolio	7.0	7.0	4.3	N/A	N/A	N/A	2.8
Mackenzie Moderate Growth ETF Portfolio	7.4	7.4	4.2	N/A	N/A	N/A	2.6
Mackenzie Growth ETF Portfolio	8.8	8.8	4.4	N/A	N/A	N/A	2.8

Commentary

The Mackenzie ETF Portfolios posted robust positive returns in the first quarter, buoyed by strong gains in both equities and bonds. Equity markets rebounded significantly in Q1 after a tumultuous end to 2018. The MSCI ACWI Index returned 12.4% in local currency terms, the biggest quarterly gain since the rebound from the financial crisis in 2009. A more dovish sounding Fed and indications of progress in the China-U.S. trade talks helped propel markets.
Similarly, bond markets also experienced one of the strongest quarters in years with the Bloomberg Barclays Global Aggregate Bond Index Hedged to CAD returning 2.8%. A global slowdown in growth alongside more dovish central banks resulted in lower yields and higher bond prices.

Asset Allocation

The construction of each Mackenzie ETF Portfolio can be decomposed into three major allocation decisions: 1) strategic asset allocation, which sets our long-term exposures to a diverse set of asset classes, 2) tactical asset allocation (shorter term in nature), which adjusts our initial strategic weights up or down based on market assessments, and 3) ETF selection. The following performance discussion addresses our total portfolio positioning, i.e. the sum of our allocation decisions, and is gross of fees.

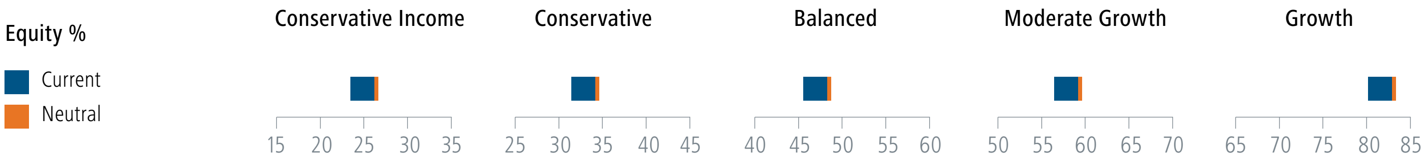
Asset allocation contribution to value added was positive on the quarter. An overweight to high yield credit was constructive to performance as investors showed a willingness to accept more risk, pushing assets like high yield bonds higher. A modest underweight equity allocation held in early January detracted a bit, but this position was subsequently lifted closer to neutral which benefited performance. Currency positioning added value and was driven by a tactical underweight to the euro, which was among the worst performing major currencies against the Canadian dollar. Our diversified approach to regional equity allocations detracted slightly from performance as increased exposures to markets outside of the U.S. (and consequently a reduction in U.S. exposure) took away from performance, as the U.S. equity market was among the leaders in the quarter.

The Mackenzie Maximum Diversification Europe Index ETF outperformed during the quarter on strong stock selection within UK equities. However, the performance of our strategic beta equity ETFs was broadly weaker in the quarter. The Mackenzie Maximum Diversification Emerging Markets Index ETF trailed its benchmark, primarily the result of an underweight exposure to China and overweight position in India. The Mackenzie Maximum Diversification US Index ETF also underperformed in the quarter. It trailed primarily because of being significantly underweight IT, which was the best performing sector in the quarter. The first quarter was a risk on period where many of the best performing sectors and countries of the past 5 to 10 years generally performed very well. In periods like these, where past winners continue to outperform and market indexes become increasingly concentrated, the patented TOBAM maximum diversification approach will tend to underperform.

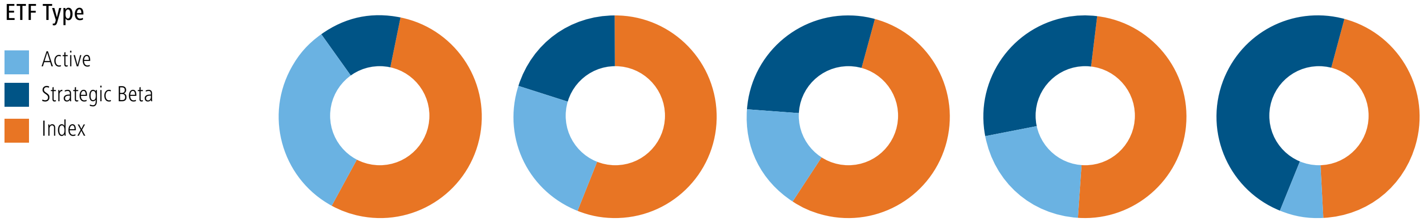
On the fixed income side, our active bond ETFs did relatively well. Mackenzie Core Plus Canadian Fixed Income ETF (our largest active income ETF allocation) outperformed due to an overweight allocation to corporate bonds, high duration within the government bond component, and strong credit selection in the financials and energy sector. The Mackenzie Global High Yield Income ETF (our second largest active income ETF allocation) performed closely in line with its benchmark.

Positioning

Equity %



ETF Type



Exposures					
Equity	25.6%	33.3%	47.8%	59.0%	81.9%
Canada	13.0%	13.9%	20.5%	20.6%	28.7%
U.S.	7.0%	10.2%	14.1%	18.5%	26.6%
International	3.5%	6.3%	8.7%	13.3%	18.0%
Emerging Markets	2.1%	2.9%	4.5%	6.6%	8.6%
Fixed Income	71.3%	64.6%	49.6%	38.3%	16.2%
Government	28.5%	24.3%	16.9%	12.4%	5.8%
Canada	27.6%	23.6%	16.1%	11.6%	5.6%
Foreign	0.9%	0.7%	0.8%	0.8%	0.2%
Corporates	21.1%	18.7%	14.6%	10.2%	2.1%
Canada	15.3%	11.8%	9.3%	6.9%	1.7%
Foreign	5.8%	6.9%	5.3%	3.3%	0.4%
High Yield	20.6%	19.2%	17.0%	14.6%	8.0%
Other	1.1%	2.4%	1.1%	1.1%	0.3%
Cash & Equivalents	3.1%	2.1%	2.6%	2.7%	1.9%

Portfolio Management Activities During the Quarter

Entering the first quarter, we were underweight equities versus cash, a position initiated in the fourth quarter of 2018. Over the first three months of 2019, our gauges of investor sentiment turned from negative to positive as investors quickly switched from being risk averse to risk seeking, in part because the Fed backed off on their prior plans to raise rates and also because trade talks between the U.S. and China appeared to show meaningful progress. As a result, we eliminated our underweight equity position in February.

In currencies, we continue to hold an underweight to the euro. We believe that the Eurozone will be challenged on the growth front, limiting the European Central Bank's ability to normalize (raise) interest rates. For the same reasons, we also initiated an underweight to the Yen during the quarter. We view Japan's growth prospects as poor relative to Canada and the U.S. Growth concerns are also limiting the Bank of Japan's ability to normalize interest rates.

Review, Outlook and Tactical Positioning

Swimming in Cross-Currents

A Bad Quarter for Growth, but a Good Quarter for Asset Prices

What a difference a quarter makes. 2018 was, by and large, a good year for the economy, at least in the U.S., but a bad one for assets. From fixed income to equities and commodities, there were few places to hide in 2018. Q1 2019, by contrast, saw strong performance for most assets – and especially for those which were hurt the most last year (e.g. Chinese equities or crude oil).

However, this positive first quarter occurred amid a notable slowdown in the real economy. The most obvious place where this is happening is the United States, which in 2018 was a bastion of strength in a decelerating world. Several U.S. economic indicators – notably manufacturing activity, housing and retail sales – have begun to point to a slower pace of expansion. Some indicators are now flirting dangerously with outright contraction.

The rest of the world, which led the U.S. on the way down in 2018, has not been spared this latest economic deceleration. Europe, a perennial pain point for the global economy, remains weak and is currently exhibiting recessionary conditions. Eurozone policy makers last year pointed to 'temporary factors' when attempting to explain the slowdown, but it now appears that something deeper has been going on in the single currency area. Germany's flash manufacturing PMI for March, at 44.7, is indicative of a relatively severe contraction in the country's export-oriented manufacturing sector.

So, we are faced with a dichotomy where assets have rallied in Q1, but where the economy has been weakening. What should we make of this?

Some Positive Changes from last Quarter…

The first element to note is that this coming economic weakness was partly priced in by markets. Asset prices tend to anticipate changes in economic conditions about six to nine months ahead of time. Therefore, what matters isn't so much what happens in the economy as what markets think will happen. So far, the growth figures do not appear to have been much worse than what was already discounted by markets given the poor equity market performance in Q4 of 2018.

For our part, the Multi-Asset Strategies Team moved to a tactical underweight position in equities in October of last year, as our analysis flagged growing risks of disappointments on the economy and on earnings. We have since moved back to neutral following the corrections, as we thought market prices to be more in line with a reduced pace of economic expansion.

An important positive factor has been the Fed's sudden shift to a more dovish stance. Fed Chair Jerome Powell's first year on the job was a little bit rocky, as he experienced a few communications mishaps. In October, he said that rates were "a long way from neutral". This spooked markets, implying that many more rate hikes were in the pipeline. Then, on December 19, he said that the Fed had its balance sheet runoff "on automatic pilot". This was horrifying for markets, suggesting that the Fed would not even consider adjusting its policy in response to weakness in the data! Following these communication problems, an important adjustment came on January 4, when Chair Powell walked back those comments, saying the Fed would be "patient". This sounds like a minor adjustment, but from our perspective, it was Powell's body language which emphasized the importance of his change of mind: he read his more accommodative comments from a piece of paper pulled out of his suit jacket. We interpreted this as an attempt to avoid yet another communications mistake by carefully reading prepared remarks instead of improvising. In our view, this meant – and still means – that rates probably won't rise above the neutral level in this cycle. Current market pricing is now consistent with Fed rate cuts later this year. This responsiveness by the Fed increases the odds of a soft landing in the U.S. economy, as opposed to a full-blown recession caused by too much tightening.

Finally, hints from the White House on the trade front seem to indicate that some progress has been made in the negotiations with China. Meanwhile, in China, we have also begun to note a push toward selective, targeted stimulus measures. The Chinese policy leadership is forced to grapple with a deterioration in the external environment and a slowdown in its main export destinations (North America and Europe). This is pushing policymakers to apply some domestic stimulus, bolstering Chinese markets.

… but Don't Get Ahead of Yourselves

Despite these positives, it isn't time to become euphoric just yet. First, it is worth taking stock of valuations. We analyze several valuation metrics across many markets, so no single indicator can summarize the entire evolution of valuations across equities. However, for illustration purposes and for simplicity, it is helpful to consider a simple forward price-to-earnings ratio on the S&P 500. After a tax cut-induced 'sugar rush', the S&P 500 was trading at 18x forward earnings at the start of 2018 – a high for the current cycle. It corrected to almost 14x by December 2018. Following the recent rally, we are now back to 16.5x. This is nothing extravagant, but it leaves less room for further improvements in case corporate earnings disappoint.

Another element which we think investors shouldn't ignore is the direction of the U.S. dollar. Emerging market currencies have shown some resilience in recent months, but the U.S. dollar has remained stubbornly strong against its developed

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market peers such as the euro and the yen. As an example, many investors would have expected the recent dovish Fed shift to push the euro much higher. It didn't. This is concerning, because 1) it highlights persistent economic weakness in non-U.S. developed economies such as the Eurozone, and 2) it squeezes companies and sovereigns which borrow in U.S. dollars. We have been underweight the euro against the U.S. dollar since last year for this very reason: we think the Eurozone economy is too weak to withstand any tightening by the European Central Bank. This remains our view. However, if the dollar continues to appreciate, it will represent a financial tightening for economies and markets.

Political risks also remain. There have been some recent indications that we are getting close to a deal between the U.S. and China on trade and sentiment has improved on this front. Any deterioration in tone from the U.S. or Chinese administrations would leave markets vulnerable to a reversal. With the Mueller Report out of the way, attention will now shift gradually to the 2020 U.S. Presidential campaign, which will highlight the deep divisions between the Republican incumbent and his Democratic challengers. Closer to home, the federal election campaign is approaching and the recent turmoil engulfing the Liberal government is likely to make the political news more volatile in the coming months.

Finally, the current soft patch in growth will need to bottom out at some point, or markets will need to revise growth expectations lower. Three scenarios are currently in play: 1) a 2016-like V-shaped rebound in global growth; 2) a 'soft landing' and stabilization at a lower level; or 3) slippage into recession. We do not think that the vigor of the 2016 rebound will be repeated, partly because China does not have the ability or willingness to stimulate as aggressively as it did then. Still, we view the country's current targeted stimulus approach as sufficient to allow the Chinese economy to experience something closer to an 'L-shaped recovery', or a stabilization.

The Elephant in the Room: Yield Curve Inversion

Another cause for caution is the current message sent by the U.S. yield curve, more specifically the spread between the 10y U.S. Treasury yield and the rate on the 3m Treasury bill. We just witnessed the first U.S. yield curve inversion since 2007, meaning that the 3m T-bill currently yields more than the 10y Treasury bond. This is typically interpreted as a sign of impending recession.

For this phenomenon to be more meaningful in terms of signalling a recession, the yield curve inversion would need to remain in place for more than just a few days or weeks. For example, if the Fed were to cut interest rates soon, the curve would probably re-steepen in response. This is similar to what happened in 1998, when the 2s10s yield curve spread (10y bond yield minus 2y bond yield) inverted briefly, but re-steepened in response to three Fed cuts. An equity market rally also ensued. However, if the Fed does not cut rates in response to recent economic weakness, the curve is likely to remain inverted, signalling a growing chance of recession.

The Bottom Line

These cross-currents are why, despite the strong performance of equity markets in Q1, the Multi-Asset Strategies Team is not adopting a more aggressive position in our asset allocation and are instead choosing to maintain a neutral position between equities and fixed income. We will be watching macro and market developments closely in the coming months and stand ready to adjust our tactical allocations in response.

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