

Morningstar Conservative Portfolio

Portfolio Commentary

- After a dramatic 2020, we (Morningstar) have seen the green shoots of “reflation”, with several significant developments co-existing.
- We’ve witnessed strong returns for equities but weak returns for bonds in the first quarter of 2021.
- Among equities, the corners of the markets that had been hot—in some cases for years—turned cold.
- In the bond market, dormant expectations for inflation began to emerge, leading to losses across interest-rate-sensitive parts of the market.

What a difference a quarter of a year makes. After a dramatic 2020, we have seen the green shoots of “reflation”, with several significant developments co-existing. The major market influences are a) inflation expectations are higher with central banks, for now, willing to let prices rise, b) economic growth forecasts increasing following solid vaccine progress, c) company reporting broadly exceeding expectations, d) geopolitical tensions and systemic risks softening, and e) investors conditioned by strong returns through good news and bad.

This culminated in strong returns for equities but weak returns for bonds in the first quarter. Among equities, the corners of the markets that had been hot—in some cases for years—turned cold. In fact, we saw a remarkable change with value stocks at the top of the leaderboard, buoyed by energy and financial companies, and technology stocks landed in the unusual position of worst performers. Smaller companies more likely to have their fortunes tied to the strength of the economy were among the best performers. Dividend-payers, which struggled in 2020, also saw a first-quarter recovery.

In the bond market, dormant expectations for inflation began to emerge, leading to losses across interest-rate-sensitive sectors of the market even as central banks committed to easy-money policies. The first-quarter bond sell-off hit government bonds the hardest, followed by safer core and corporate bonds. Only high-yield bonds managed to end the quarter just in positive territory.

In the background, the yield curve (which looks at the effective interest rate for governments over different time periods) steepened severely from three months ago on expectations for stronger economic growth. For example, the 10-year government bond yield in Canada rose from 0.67% to 1.55% in the quarter, reaching pre-pandemic levels.

On a year-over-year basis, a more compelling story emerges as the scope of the bounce back from the depth of last year’s brutal bear market becomes clear. From where it ended in the first quarter of 2020, stocks are up significantly.

Meanwhile, under the hood of the stock market, we continue to see significant changes in leadership. Perhaps most notable is the recent strength in value stocks, which have been lagging significantly in recent years. Still, the longer-term performance gaps in preference of growth stocks remain wide. While losing the least in the bear market, wide-moat stocks have lagged in the recovery.

Domestic fixed income indices were shaken in the first quarter, with the FTSE Canada Universe Bond Index declining 5.04% and the FTSE Canada Short Term Bond Index down 0.59%. Returns in global fixed income also lagged, with the FTSE World Government Bond Index down 3.09% in local terms, and down 6.95% in Canadian dollars in the period. Canadian Real Return Bonds suffered with a -7.3% return in the quarter.

Domestic stocks, as represented by the S&P/TSX Composite, had another strong return of 8.05% in the first quarter. Health Care had the highest returns, up 38.3% in the period, and the Energy sector continued its rebound with a 29.1% return. Small Cap stocks continued to run ahead of the broader market, with the S&P/TSX Small Cap index up 9.74%.

The S&P 500 gained 4.63% in the first quarter in Canadian dollar terms. The MSCI EAFE Index of foreign developed markets rose a comparatively modest 2.09%, and the MSCI Emerging Markets Index rose 0.91%.

The information contained herein is subject to important disclosures and disclaimers contained in the Disclosure Statement on the last page of this document. This document is not complete without such Disclosure Statement.



Morningstar Conservative Portfolio

The Morningstar Conservative Portfolio outperformed its blended benchmark¹ during the first quarter.

Positive Contributors

- Relative performance in foreign fixed income from PIMCO Monthly Income Fund and Leith Wheeler High Yield Bond Fund.
- Energy exposure via Global X MLP & Energy Infrastructure ETF.

Performance Detractors

- Absolute returns from domestic fixed income managers.
- Real Return Bond exposure.

Activity and Valuation-Driven Asset Allocation Positioning:

After an active 2020, the first quarter of 2021 saw no changes in our target exposures.

Overall, the portfolio remains slightly below a neutral weight in equities versus our benchmarks. Intra-equity, we continue to remain overweight non-U.S. equities, specifically value-leaning securities, and sectors such as energy and financials, and countries such as Japan, as they remain among the more attractive areas in the equity market by our analysis.

In fixed income, we remain slightly underweight duration and overweight emerging-markets debt. Despite the low probability of inflation rising in the short term, we remain overweight Real Return Bonds for diversification and as a form of insurance against unexpected future inflation.

¹The Morningstar Conservative Portfolio's benchmark comprises 54% FTSE TMX Canada Universe Bond Index, 16% FTSE World Government Bond Index in Canadian dollars, 6% S&P/TSX Composite Index, 14%

MSCI All Country World Index ex Canada IMI Index in Canadian dollars and 10% FTSE TMX 91 Day T-Bill Index.

Morningstar Conservative Portfolio

FOR DISTRIBUTION TO INVESTORS BY REGISTERED DEALERS ONLY.

Bridgehouse Asset Managers® is a trade name of Brandes Investment Partners & Co. (Bridgehouse). Brandes Investment Partners® is a registered trademark of Brandes Investment Partners, L.P. (Brandes LP), which is an affiliate of Bridgehouse. Bridgehouse is the manager of the Bridgehouse Funds and has hired Brandes LP, Lazard Asset Management (Canada), Inc. (Lazard), Morningstar Associates Inc. (Morningstar), Sienna Investment Managers Inc. (Sienna), GQG Partners LLC (GQG Partners) and TD Asset Management (TDAM) as portfolio sub-advisors (collectively, the “portfolio sub-advisors”) in respect of the Bridgehouse Funds. The foregoing reflects the thoughts, opinions and investment strategies of Bridgehouse and/or the portfolio sub-advisors and is subject to change at their discretion, based on changing market dynamics or other considerations. Bridgehouse and the portfolio sub-advisors have taken reasonable steps to provide accurate and current data. The data has been gathered from sources believed to be reliable, however Bridgehouse and/or the portfolio sub-advisors are not responsible for any errors or omissions contained herein. Indices are unmanaged and cannot be directly invested into. Securities mentioned herein are not to be construed as a recommendation to buy or sell. Past performance is not a reliable indicator of future results. This material has been provided by Bridgehouse and is for informational purposes only. It is not intended to provide legal, accounting, tax, investment, financial or other advice and is not to be construed as a recommendation to buy or sell. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. This report may contain forward-looking statements about the economy, and markets; their future performance, strategies or prospects. Units and shares of the Bridgehouse Funds are available through registered dealers only and are not available through Bridgehouse.

The words “may,” “could,” “should,” “would,” “suspect,” “outlook,” “believe,” “plan,” “anticipate,” “estimate,” “expect,” “intend,” “forecast,” “objective” and similar expressions are intended to identify forward-looking statements. Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties about general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. You are cautioned to not place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement. Before making any investment decisions, you are encouraged to consider these and other factors carefully. Where applicable, please note that MSCI has not approved, reviewed or produced this report, makes no express or implied warranties or representations and is not liable whatsoever for any data in the report. You may not redistribute the MSCI data or use it as a basis for other indices or investment products.

Published May 17, 2021

