

Fixed-income update

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SHANE STUCK, CFA, MBA

Vice-President and Senior Portfolio Manager

JIE LIU

Associate Portfolio Manager

SENTRY CONSERVATIVE BALANCED INCOME FUND

- Sentry Conservative Balanced Income Fund is index-agnostic, meaning it aims to provide return and minimize risk without an eye to the index.
- It also means it generally owns a small percentage of preferred shares; however, if there are opportunities in the US, the Fund will take those opportunities.
- We maintain an “A” average credit rating in this Fund since it’s geared towards the more conservative investor.
- A small portion of the Fund will be in “BB” credit because such investments may result in greater rewards than “A” credit investments.
- The Fund has returned 15.4% over the past 12 months (as at May 31, 2011), and going forward, we’re going to hold to our successful strategy. (The return since inception – March 17, 2010 – was 11.5% as at May 31, 2011.)

SENTRY TACTICAL BOND FUND

- For Sentry Tactical Bond Fund, the focus is on yield. We have currently set the yield target at approximately 6% or \$0.05 a month. We’ve achieved this over the last 12 months.

- In comparison, as interest rates have fallen, a three- or 10-year Government of Canada bond will now yield below 3%.
- We want to focus on global markets. There’s no reason to restrict ourselves to looking at 1% of the global credit market and leave 99% untouched.
- We think that emerging markets will be a driving force in the global economy this year and for many years to come, so this is where we give additional focus.
- We stress risk more in our analysis than we do yield. This Fund has about 70% of its assets in US dollars. The Canadian dollar has appreciated about \$0.12 since we launched the Fund last year. We’ve maintained a NAV above \$10.
- Interest rates are probably going to be one of the bigger risks that we face over the next few years. Ten-year interest rates are below 3%. There is the risk of higher interest rates, but probably not for the rest of this year and maybe not even in 2012. But it is going to be a risk.
- Credit is also a big risk and we don’t think people address it properly. The US Treasury has just been put on credit watch by Moody’s, and Columbia, an emerging market, just achieved double investment grade by both rating agencies.

- We're in an environment now where you probably want to take a risk in corporate bonds, but not with sovereigns. Some asset managers don't address risk properly when it comes to corporate credit, because they focus on individual names and not on how those names work in a portfolio to reduce the overall risk.
- Diversifying across most or all industry sectors, as well as globally, reduces the systematic risk of the portfolio.
- There's a different type of risk when you invest in 10-year treasuries which are now below 3%, as well as investment-grade securities.
- When we can maintain a portfolio yield of 8.25% to 8.50%, you're not taking that risk as an investor.
- It's important to look at the Fund and how it performs against inflation, because inflation means higher interest rates. This Fund has a very low relative duration relative to the universe in Canada. The higher the duration, the more interest rate exposure you have.
- We prefer to achieve our yield with alpha and we tend to try to manage our interest-rate risk. We keep it relatively short, and we will use interest rate features if we think we're going to get into that elevated interest rate environment, so you might actually see our duration even a little bit shorter than it currently is.
- We invest in big coupon bonds which bake a lot of protection into the Fund. If you're getting a cash flow of 10%, 11% or 12%, and interest rates are rising and there are investments available where you can reinvest that big cash flow at higher interest rates, that's protection.
- Global investing gives you a powerful tool as an asset manager. The ability to shift your weights globally allows you to diversify that risk. For example, short-term interest rates may rise in Canada but that doesn't necessarily mean that same risk applies uniformly across the world.
- We're not in an environment now where you have to be concerned a lot with credit risk. We do keep an eye on it, but what we look at tends to be a green light because we're in a balance-sheet recession. That means companies start to deleverage and their credit quality improves.
- In 2010, the global default rate for high-yield credit was about 3.1% and is projected to be around 2.4% this year. We're still in an environment where you are being rewarded to focus on credit, and that reward, in terms of this Fund, is a 6% payout.
- We currently look at, for the most part, US dollar issuance and some euro issuance. We tend to shy away from local currency issuance. We hedge our currency, and the US dollar is currently a cheap hedge.
- We look at companies that are focused on their domestic markets. They're not focused on being the exporter to the US consumer that's to a large extent tapped out. But you still have billions of people that are moving up the economic ladder in other nations.
- We look at companies that are large. Big employers have quality financial reporting. We look at companies that have a dominant position in their market segment. We don't want somebody that's number seven that wants to be number one. We prefer to have a number one that's going to stay number one.

- Inflation is still the number one risk that people worry about around emerging markets, especially in Asia. Inflation is a risk, but we need to put it into context to determine real risk/reward. Asset bubbles are the other area of concern.
- China is running inflation of slightly over 5% and it has a GDP of over 9%. That means it is generating real GDP growth of over 4%. In comparison, US GDP is around 2% to 3%.
- Another point is that we believe inflation is peaking. China has raised interest rates four times over the past six months so inflation is coming down. Inflation will probably peak in June so that risk is coming off compared to robust economic growth. We think it will be a very good environment for investors to generate a very decent return.
- We don't believe the housing bubble in China, if it exists, will burst in the next three to five years. We keep the duration short if we're exposed to that market.
- We are trying to create a corporate high-yield fund with an emerging market focus.
- High-yield emerging markets are not very mature but are growing. A newly growing market will provide better return with little risk.
- The high-yield issuance in emerging markets, particularly Asia, is growing fast due to economic growth. Right now you're seeing more resources and industrial companies as opposed to the property developer companies we saw three to six months ago.
- We believe Asia has the best corporate balance sheet globally right now.
- One name we've invested in is Lumena Resources, a Chinese company. It is becoming one of the largest holdings in the portfolio. Others are overlooking this company because it has a very short track record in the public market. But the company has been there for a long time.

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