CALDWELL INCOME FUND

October 2017

Bond Strategy Update

William Chin, MBA, *Portfolio Manager,*
Caldwell Income Fund & Caldwell Balanced Fund

OVERVIEW

With inflation subdued and growth at best moderate, bond yields in the United States have been trending lower. The U.S. Treasury 10-year yield fell to 2.03% on September 7, 2017. This is a significant drop from the high of 2.62% on December 16, 2016, shortly after the U.S. election.

THE BANK OF CANADA

Government of Canada bonds participated in this bond rally up until early June 2017, when the Bank of Canada signaled it might want to remove the 0.50% interest rate cuts that it implemented to cushion the crude oil crash. Bond yields in Canada started to rise significantly. The Bank of Canada raised the benchmark interest rate from 0.50% to 0.75% on July 12, 2017 and raised it from 0.75% to 1.00% on September 6, 2017.

As a result, the Government of Canada 10-year bond yield rose from 1.39% on June 6, 2017 to 2.13% by September 27, 2017. The Canadian dollar appreciated dramatically from 74.3 U.S. cents to 82.9 U.S. cents in the same period.

The higher loonie and higher interest rates together tightened overall financial conditions in Canada. One can logically expect these policy actions will have negative effects on the Canadian economy.

Indeed, Gross Domestic Product ("GDP"), a measure of economic growth, came in flat for July, in other words there was no growth. Since the first rate increase was on July 12, 2017, its full impact was not felt until August. The second rate increase was on September 6, 2017 and its full impact was felt through that month and into the fourth quarter.

Bank of Canada Deputy Governor Timothy Lane spoke on September 18, 2017 and expressed concerns regarding the strong Canadian dollar and that it will factor "strongly" in their future decisions. Unlike the Federal Reserve, officials from the Bank of Canada speak with one voice. It is very clear that the Bank of Canada does not like the loonie at 82 U.S. cents and wants it lower. Lane also mentioned their concern about higher interest rates and elevated levels of household debt. We expect the 'element of surprise' accompanied with the two rate hikes will have an oversized impact on the Canadian economy. As growth and inflation expectations are pared back by these rate hikes, longer-term bond yields will fall.

Bank of Canada Governor Stephen Poloz spoke on September 27, 2017 and reinforced Lane's message. He also expressed concerns about how the elevated level of household debt could "amplify" the impact of the rate increases. In short, the Bank of Canada has started to question its two interest rate increases and will likely tread more carefully going forward.

FISCAL POLICIES

At the same time our Finance Minister, Bill Morneau, is planning to raise business taxes. Note that small businesses are the greatest source of job growth in our economy. In Ontario, minimum wage will be hiked by over 20%. In has been proved that a higher minimum wage hurts marginally employable workers and most economists would agree it is a bad idea. Both measures are not friendly to consumption and growth. Overlay that with a policy mistake by the Bank of Canada, which presents more headwind for growth, and we have an environment in which Government of Canada bonds are currently offering excellent value.

BOND STRATEGY

The Caldwell Income Fund is actively managed and our managers have significantly shielded our portfolio from the impact of rising bond yields and it is now well-positioned to benefit from the vastly undervalued Government of Canada bonds, which will appreciate in value when the economy weakens from the ill-timed and inappropriate interest rate increases, the overly strong Canadian dollar and misplaced tax policies.

The strength in equities brings more opportunity for investors to diversify and reduce risk in their portfolios by moving, in a measured manner, from equities to the safety of Government of Canada bonds, which are AAA-rated.

PORTFOLIO MANAGER

William Chin, MBA
Fixed Income Portfolio Manager & Chief Technical Analyst
wchin@caldwellinvestment.com

William has an MBA in economics and international finance. He is the lead Portfolio Manager on the Caldwell Income Fund and Portfolio Manager for the fixed income portion of the Caldwell Balanced Fund. He also manages fixed income portfolios for Caldwell's separately managed account platform.

Mr. Chin assumed responsibility for managing the Caldwell Income Fund in November 2015. Following which, he repositioned the Fund's portfolio to invest in government bonds, rather than a balance of equities and fixed income securities. He also initiated the launch of the Fund's Series I units in July 2016.

To Subscribe to Quarterly Bond Strategy Updates
Sign-Up to our Mailing List at www.caldwellinvestment.com/contacts

ABOUT CALDWELL

Established in 1980, and founded by Thomas S. Caldwell C.M., Caldwell Investment Management Ltd. ("Caldwell") provides full service investment management, advisory and custodial services to individual and institutional investors. For over 35 years, Caldwell has established and maintained its reputation for excellence in the investment management industry, providing innovative investment solutions to meet the requirements of individual and institutional investors. Caldwell practices "Thoughtful Investing", applying a disciplined and prudent long-term investment approach. Capital preservation is the key to investment success.

To schedule a meeting with the Caldwell Team or for more information on our strategies, contact us at:

1-800-256-2441 | 416-593-1798 or funds@caldwellinvestment.com

Visit our website at www.caldwellinvestment.com

Caldwell Investment Management
THOUGHTFUL INVESTING