Credit Absolute Return Strategy

As of April 30, 2018

Strategy description

The Credit Absolute Return strategy invests in diversified long and short positions of North American credit securities with an objective to generate positive returns throughout a complete credit cycle. Credit selection serves as the key pillar of strategy, supported by independent fundamental credit analysis. The investment team maintains a diversified and liquid portfolio with reduced interest rate risk exposure and an average credit rating of investment grade. The primary drivers of performance throughout the credit cycle include:

- Leveraged investment grade credit
- Long/short credits
- Arbitrage opportunities

Why invest?

- An alternative to a traditional fixed income portfolio with strong diversification benefits.
- Credit-driven returns with reduced sensitivity to interest rate risk.
- Ability to generate positive returns throughout a complete credit cycle.

Portfolio characteristics

Bond rating (%)	Long	Short	Net
AAA	70.6	-124.5	-53.9
AA	47.2	0.0	47.2
A	40.4	-13.7	26.7
BBB	69.5	-11.4	58.0
BB	26.2	-5.0	21.2
B	0.0	0.0	0.0
Not rated	0.4	0.0	0.4
Total	**254.6**	**-154.6**	**100.0**

Portfolio exposure (%)	Long	Short	Net
Investment grade	140.5	-22.2	118.2
High yield	23.3	-4.9	18.4
Bank loans	4.2	0.0	4.2
Cash, short-term investments and other net assets	79.3	0.0	79.3
Government bonds	1.1	-124.5	-123.4
Preferred stocks — CDN	3.2	-3.0	0.2
preferred stocks — USD	3.1	0.0	3.1
Options	0.0	0.0	0.0
Total	**254.6**	**-154.6**	**100.0**

Characteristic	
Duration	0.62
Weighted Average Credit Weighting	A+
Gross Leverage	1.5 X

Highlights

Inception	December 31, 2013
Strategy AUM	$228 MM
Liquidity	Daily
Holdings	176
Currency	100% hedged
Incentive fee	Yes
High water mark	Annual
Hurdle rate	5%

Performance

Compound returns (%)

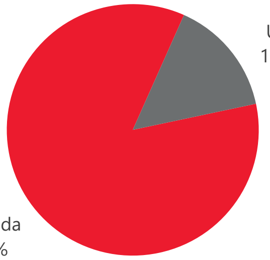
1 mth	3 mth	6 mth	1 yr	2 yr	3 yr	Inception
0.20	-0.49	1.12	3.54	7.70	8.07	9.58

Calendar year returns (%)

YTD 2018	2017	2016	2015	2014
0.49	7.97	6.91	12.95	13.47

Top corporate issuers (%)	
Canadian Oil Sands	11.3
Choice Properties	10.3
Bank of Nova Scotia	8.7
CIBC	8.6
Toyota	6.6
Wells Fargo	6.6
Enbridge	6.1
Ford Credit Canada	5.3
BCE	5.1
OMERS Realty Corp	4.8
Total	**73.3**

Geographic allocation



Comparative analysis (since inception)

	Credit Absolute Return Strategy	FTSE TMX Canadian Universe Bond Index	Barclays High Yield VLI C$ Hedged	S&P / TSX Composite Index
Annualized Return	9.58%	3.58%	4.12%	6.27%
Standard deviation	4.48%	4.02%	5.74%	7.49%
Sharpe ratio	1.87	0.59	0.51	0.68
% of positive months	87%	62%	65%	63%
Max drawdown	-4.25%	-3.55%	-10.64%	-13.77%
Yield to Maturity C$	3.10%	2.70%	6.45%	NA
Avg Modified Duration	0.62	7.26	3.99	NA
Avg. Credit Rating	A+	AA	B1/B2	NA
Correlation to Fund		0.06	0.13	0.13

Source: Bloomberg, FTSE TMX Global Debt Capital Markets

Scotia Institutional Asset Management™

Performance returns for the Credit Absolute Return Composite (“Strategy”) are included to demonstrate how an investment fund with a similar investment strategy performed over the time period indicated. Periods of more than one year are annualized. Portfolio characteristics are of the Scotia Institutional Credit Absolute Return Fund. There is no guarantee that the Strategy would have invested in the same holdings as the Fund, and actual performance would have been different due to differences in underlying holdings and inception periods. The indicated rates of return are reported net of trading expenses but before the deduction of management fees. Past performance is no indicator of future performance.

Portfolio commentary (as of April 30, 2018)

Marc-André Gaudreau, CPA, CGA, CFA, Vice President & Portfolio Manager, Fixed Income

The Credit Absolute Return Fund returned 0.20% in April as corporate spreads stabilized over the period and the leveraged investment grade strategy generated positive performance. Both the long/short and the credit arbitrage strategies were flat during the period. With higher rates impacting traditional bond solutions over the past 6 months, we want to remind investors that The Credit Absolute Return Fund has very little interest rate risk. The fund employs three underlying strategies: 1) leveraged short-term investment grade bonds, 2) long/short credit opportunities and 3) credit arbitrage. As a rule of thumb, Strategy 1 tends to be correlated with liquid corporate spreads while Strategy 2 tends to generate capital gains when weaker borrowers start to underperform. Strategy 3 tends to be applied when there is panic in the markets and arbitrage opportunities abound.

We have been relatively conservative in terms of our positioning in the strategy, as our amount of leverage applied in Strategy 1 over the past several months has been limited, therefore reducing our income. Meanwhile, we have maintained a consistent exposure to Strategy 2 and given the lack of volatility in credit spreads we have seen very little opportunity for Strategy 3. Our objective remains to generate mid-single digit returns over the entire credit cycle and we are comfortable with the existing low active risk of the fund. The weighted average rating of the fund remained at A+, while the yield to maturity is 3.10% and the interest rate duration remained low at 0.62 years. We made the following adjustments to the portfolio in April:

- As Enbridge continues to fund its expansion capital projects, the company must provide increasing new issue concessions and we took advantage of this by participating in the recent C$ hybrid new issue. The new 10-year issue had a 6.625% coupon and a +445bps spread, translating to a new issue concession of 45bps, which is unusual and attractive in our mind. The bonds performed very well in the secondary market (up $2 on the break). We took the opportunity to short expensive C$ Enbridge preferred shares that are still trading close to $25.

About Scotia Institutional

Scotia Institutional Asset Management provides progressive and innovative investment solutions to meet the challenges facing institutional clients, including pension funds, non-profits, foundations and corporations.

$124 Billion assets under management*

Fixed Income

The Scotia Institutional Asset Management fixed income team offers a diverse set of fixed income capabilities and solutions, ranging from traditional benchmark-driven to absolute return strategies. We seek to deliver alpha over a full market cycle through the application of a capital preservation philosophy and distinctive investment processes designed to optimize the trade-off between reward and risk.

To complement the skills of our fixed income team, proprietary systems help identify, quantify and manage risks associated with the market. This combination of skills and technologies enables a proactive approach to protecting and growing our clients' capital.

For more information, please contact:

Trevor Boose, MBA, CFA, Institutional Business Development • trevor.boose@scotiabank.com • 416.350.3299

Ontario (head office): 1 Adelaide Street East, 23rd Floor, Toronto, ON M5C 2V9

* As at March 31, 2018. AUM is for 1832 Asset Management L.P., a limited partnership the general partner of which is wholly owned, directly and indirectly, by The Bank of Nova Scotia and is a manager of mutual funds and investment solutions for private clients, institutional clients and managed asset programs.