Credit Absolute Return Strategy

As of August 31, 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	72.9	-131.6	-58.8
AA	63.5	0.0	63.5
A	44.8	-12.7	32.1
BBB	59.8	-13.5	46.3
BB	21.1	-5.2	15.9
B	0.0	0.0	0.0
Not rated	1.0	0.0	1.0
Total	**263.0**	**-163.0**	**100.0**

Portfolio exposure (%)	Long	Short	Net
Investment grade	143.7	-22.7	121.0
High yield	19.0	-4.9	14.1
Bank loans	4.2	0.0	4.2
Cash, short-term investments and other net assets	90.3	0.0	90.3
Government bonds	1.0	-131.6	-130.6
Preferred stocks — CDN	3.5	-3.8	-0.3
preferred stocks — USD	1.3	0.0	1.3
Options	0.0	0.0	0.0
Total	**263.0**	**-163.0**	**100.0**

Characteristic	
Duration	0.52
Weighted Average Credit Weighting	AA-
Gross Leverage	1.4 X

Highlights

Inception	December 31, 2013
Strategy AUM	$229 MM
Liquidity	Daily
Holdings	202
Currency	100% hedged
Incentive fee	Yes
High water mark	Annual
Hurdle rate	5%

Performance

Compound returns (%)

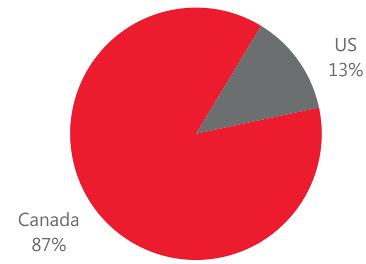
1 mth	3 mth	6 mth	1 yr	2 yr	3 yr	Inception
0.10	0.59	0.39	2.62	6.29	7.93	8.40

Calendar year returns (%)

YTD 2018	2017	2016	2015	2014
1.09	7.88	6.60	12.57	11.36

Top corporate issuers (%)	
Canadian Oil Sands	11.2
CIBC	9.7
TD	9.7
Bank of Nova Scotia	7.8
Royal Bank of Canada	6.2
Toyota	5.9
Choice Properties	5.7
OMERS Realty Corp	5.5
Wells Fargo	5.4
Ford Credit Canada	5.2
Total	**72.3**

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	8.40%	3.63%	4.27%	6.97%
Standard deviation	4.16%	3.85%	5.40%	7.36%
Sharpe ratio	1.65	0.54	0.51	0.74
% of positive months	84%	63%	66%	64%
Max drawdown	-4.45%	-3.55%	-10.64%	-13.77%
Yield to Maturity C$	3.67%	2.75%	6.51%	NA
Avg Modified Duration	0.52	7.49	3.82	NA
Avg. Credit Rating	AA-	AA	B1/B2	NA
Correlation to Fund		0.07	0.14	0.11

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 be 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 August 31, 2018)

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

The Credit Absolute Return Strategy returned 0.10% during August as North American credit spreads were relatively stable, leading to a positive contribution from the leveraged investment grade strategy, which was partially offset by negative performance in the long/short strategy.

In a continuation of July's theme, a lack of primary issuance and low dealer inventories maintained a decent tone to secondary credit spreads. After strong performance in July, US corporate spreads gave back approximately 5 bps while Canadian corporate spreads remained largely unchanged. We did see some cracks start to emerge in certain sectors during the month, most notably the auto sector where credit spreads were under pressure as concerns regarding NAFTA and increased tariff rhetoric weighed on the sector overall.

As part of the long/short strategy, we continue to maintain short positions in weaker credits that are expensively valued and most exposed to a slowdown in Canadian housing. We believe that the current risk/reward relationship of these short positions is skewed asymmetrically in our favour and our conviction in these positions gained further support following Teranet's Q2 earnings report released in August. Teranet, owned by OMERS Infrastructure, is the exclusive provider of Ontario's online property search and registration system and operates a similar system in Manitoba. The company's Q2 report showed slowing Ontario registration volumes, largely driven by the introduction of the Ontario Fair Housing Plan and new OSFI B-20 regulations, which came into effect in April 2017 and January 2018, respectively. Management guidance suggests the volume slowdown will persist through Q3 as well. History has shown us that falling real estate transaction volumes is a leading indicator and usually precedes pressure on housing prices. We believe that a cooling off of the Canadian housing market driven by government regulations, tighter lending conditions, and higher mortgage rates will translate to strong performance from our short positions as part of this theme.

During the month, we managed to take advantage of the quiet market conditions to add to several lines at attractive levels in addition to performing customary rebalancing activities. Following Teranet's weak Q2 report, we topped up our short positions in certain credits that make up our Canadian housing theme. The strategy participated in select new issues and monetized gains in some issues which performed strongly over the summer. Looking forward, we expect the primary market to heat up in September as investors return from vacation and issuers look to complete funding programs before year end.

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.

$128 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:

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* As at June 30, 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.