

# Governance Report

FOURTH QUARTER 2017 | DECEMBER

## What's inside this report?

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- Melodia Funds Performance Review
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## The Foresight Solution

Our group retirement product and service offer for small to medium-sized businesses is known as Foresight. Since its launch, the Foresight solution has been evolving to better meet the needs of the market. The revamped solution includes the Melodia Funds, in which fund manager selection, governance and monitoring are provided by investment experts at the Desjardins Group. In addition, the Melodia Funds provide exposure to non-traditional asset classes, which optimize performance by increasing diversification.

## Your Responsibilities as a Plan Sponsor

The Capital Accumulation Plan (CAP) guidelines\* enacted by the Joint Forum of Financial Market Regulators outline the duties and responsibilities of retirement savings plan sponsors (employers). The purpose of these guidelines is to make sure that plan participants (employees) receive enough information to make informed investment decisions. The advantage of the Foresight solution is that you can delegate these responsibilities to Desjardins experts committed to giving you the very best in governance services.

\* When we refer to the CAP guidelines we also refer to the Defined Contribution Pension Plan Guideline issued by CAPSA, if applicable.

# Economic Commentary – Q4 2017

Stronger-than-expected earnings continued to fuel the major stock markets in the fourth quarter of 2017. U.S. stock markets stood out in particular, boosted by the adoption of the Trump administration's tax reform package after months of uncertainty and a jump in earnings for the tech sector.

In Canada, unemployment fell to a record low of 5.7% in December. Positive economic indicators helped drive the S&P/TSX Composite Index up by 4.5% over the quarter. However, its advance was held back by the energy sector, which returned just 0.7% despite rising oil prices. Furthermore, the Bank of Canada (BoC) opted to pause its monetary tightening, holding its overnight rate steady at 1%. Meanwhile, the Canadian bond market, as represented by the FTSE TMX Canada Universe Bond Index, posted a quarterly return of 2.0%.

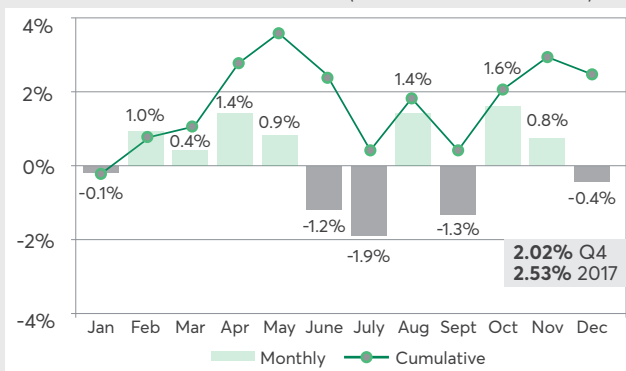
In Europe, political conditions in several countries continued to pose substantial risks for the region. These include the re-election of a separatist government in Catalonia and Angela Merkel's difficulties forming a new coalition government in Germany. The result was muted growth for European stock market indices.

This was the final quarter in a year marked by better-than-expected global economic growth, which lifted global stock markets. Stock markets in emerging countries, especially in Asia, led the way in 2017, with the MSCI Emerging Markets Index 1 turning in annual growth of 28.3%.

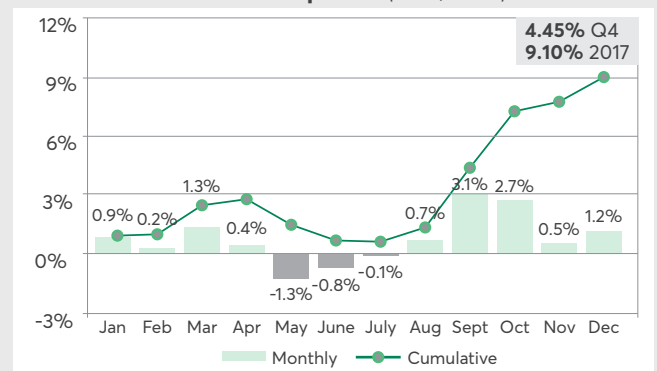
In the United States, tech companies and the tax reform package contributed to a 13.8% increase for the S&P 500 Index, which has now posted gains for nine years running. After three tough years for Europe, positive economic news and election results that were mostly welcomed by investors helped heat up European stock markets, which delivered a 17.3% annual return. Although the underperformance of the energy and materials sectors took a toll on the S&P/TSX Composite Index, the index as a whole still rose by 9.1%. As for fixed income, rosier economic outlooks encouraged major central banks around the world to tighten their monetary policies. The Bank of Canada and the U.S. Federal Reserve (Fed) both hiked their key interest rates. As a result, their respective bond markets suffered, with the Canadian market growing by just 2.5%, while the U.S. market slid by 3.3%. It is also worth noting that throughout 2017 the Canadian dollar appreciated against the U.S. dollar, biting into returns on U.S. dollar-denominated securities. In contrast, Canada's currency depreciated against the euro, magnifying the performance of euro-denominated investments.

## Returns – Main Indices

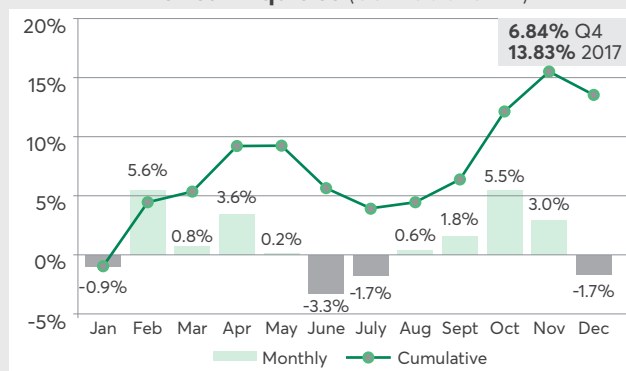
**Canadian Fixed Income (FTSE TMX Universe)**



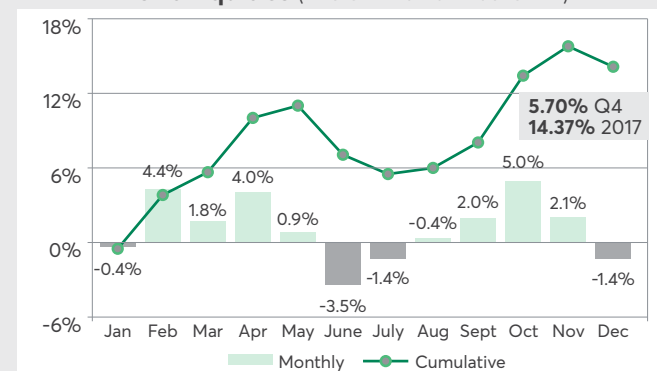
**Canadian Equities (S&P/TSX)**



**American Equities (S&P 500 CAD)**



**World Equities (MSCI World Net CAD)**



## Melodia Funds – Performance Review

- All five Melodia Funds recorded positive absolute returns during the fourth quarter of 2017. On a relative basis, all Melodia Funds outperformed their respective benchmarks during the quarter.
- Over the last twelve months, all Melodia Funds generated positive returns and all five funds outperformed their respective benchmarks. Added value ranged between 2.59% and 4.47%.
- For a fourth quarter in a row, the Melodia funds with the largest portion allocated to equity (Aggressive and Maximum) recorded the most positive absolute performance.
- The bond component had positive contributions from allocation to both Canadian and foreign bonds this quarter. Bond funds posted returns between -0.52% (Desjardins Short-term Income Fund) and 2.18% (Desjardins Canadian Bond Fund).
- As for the equity component, the Canadian funds had a good quarter with positive returns for all funds. International funds generally registered better performance than Canadian funds. The fund that contributed the most to performance was the Desjardins Emerging Markets Opportunities Fund (10.72%). The Desjardins Canadian Equity Value Fund contributed the least (3.99%).

### Gross Rates of Return (%)

December 31, 2017

FUND	Annualized Returns								
	YTD	1 mth	3 mths	1 yr	2 yrs	3 yrs	4 yrs	5 yrs	10 yrs
0224 Melodia Moderate Growth <sup>1</sup>	8.94	-0.25	3.31	8.94	6.80	6.16	6.89	7.65	N/A
Benchmark*	6.36	-0.35	3.06	6.36	5.43	5.38	6.41	6.95	N/A
0226 Melodia Diversified Growth <sup>1</sup>	10.75	-0.23	3.81	10.75	8.09	7.15	7.71	8.40	N/A
Benchmark*	7.56	-0.37	3.43	7.56	6.44	6.23	7.17	7.91	N/A
0228 Melodia Balanced Growth <sup>1</sup>	12.40	-0.23	4.27	12.40	9.06	7.99	8.40	9.51	N/A
Benchmark*	8.74	-0.39	3.81	8.74	7.40	7.06	7.92	8.90	N/A
0230 Melodia Aggressive Growth <sup>1</sup>	14.64	-0.24	4.94	14.64	10.61	9.25	9.52	11.39	N/A
Benchmark*	10.45	-0.41	4.37	10.45	8.77	8.26	9.01	10.74	N/A
0232 Melodia Maximum Growth <sup>1</sup>	16.05	-0.24	5.38	16.05	11.45	10.02	10.19	12.47	N/A
Benchmark*	11.57	-0.43	4.74	11.57	9.66	9.05	9.74	11.83	N/A

<sup>1</sup> Returns including historical returns of underlying funds and/or strategy.

<sup>1</sup> Returns calculated before December 2013 are simulated according to the allocation of Melodia funds in force before this date.

\* See benchmark on the funds pages.

Past performance is no assurance or indicator of future returns.

# Governance

## Desjardins Governance Process – The Four P's

Our meticulous monitoring program is done by a dedicated team of investment experts and includes rigorous processes to select and monitor fund managers.

When selecting fund managers, we examine the objectives and constraints that managers will face and then seek managers most likely to successfully meet all requirements. It is imperative that their risk-return strategies correspond to the investment policies, guidelines and overall needs of our plan sponsors with principles in line with ours.

A combination of factors will be taken into consideration such as the manager's innovative and proven philosophy under various circumstances, adherence to the portfolio's investment policy / strategies and long-term performance. As a result, we only select top-quality fund managers with complementary management styles to offer a well-balanced, diversified selection of funds.

Every quarter, an analysis is conducted on each of the funds offered on our platform. Four main criteria, the four P's, are used: People, Process, Portfolio and Performance.

People	Process	Portfolio	Performance
<ul style="list-style-type: none"> <li>• Has the investment team been stable?</li> <li>• Are the portfolio managers and research analysts experienced? Do they have complementary skills?</li> <li>• Does the ownership structure align the employees' interests with those of clients?</li> </ul>	<ul style="list-style-type: none"> <li>• What are the aspects and characteristics of the investment process and how is it applied?</li> <li>• Is the investment process clearly defined and consistently applied?</li> </ul>	<ul style="list-style-type: none"> <li>• Are the portfolio holdings consistent with the style of the approach?</li> <li>• How diversified is the portfolio, what is the concentration by sector and how many securities are held?</li> </ul>	<ul style="list-style-type: none"> <li>• What are the sources of outperformance and underperformance?</li> <li>• Is the volatility of the fund appropriate given the mandate?</li> </ul>

This analysis allows us to determine our level of comfort with each of the funds. Funds that do not meet one or more of these criteria are placed on a watch list, which means they are monitored more closely and a specific correction plan is put in place.

## Executive Summary – Q4 2017

At this time, two underlying mandates composing the Melodia Funds are being followed closely:

- The Desjardins Global Corporate Bond Fund, sub-advised by AllianceBernstein, is being monitored due to its underperformance and changes to upper management.
- The Desjardins Overseas Equity Value Fund, sub-advised by Aberdeen, is being monitored due to its underperformance and important organisational changes.

All the other mandates adequately meet our four governance criteria.

No changes are recommended at this time, but in keeping with our good governance practices, rigorous monitoring of these mandates will be done and we will keep you informed of any developments.