

Governance Report

FOURTH QUARTER 2018 | DECEMBER

What's inside this report?

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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 2018

The final quarter of 2018 was marked by concern for the global economy, which hamstrung the performance of the major stock markets. Trade tensions caused a general slump in international trade, weakening economic growth in export countries. All the same, the global economy continued to grow faster than expected, and a détente in the U.S. – China trade war provided encouraging signs for the future.

In Canada, the labour market broke two new records: the most new jobs created in a month and the lowest unemployment rate since 1976. But that didn't save the S&P/TSX composite index (total return) from a 10.1% loss for the quarter, chiefly due to an unexpected fall in domestic demand and a slowdown in the energy sector. On the bond side, after announcing a rate hike in October, the Bank of Canada left its key rate untouched in December, suggesting it might ease up on its monetary tightening policy.

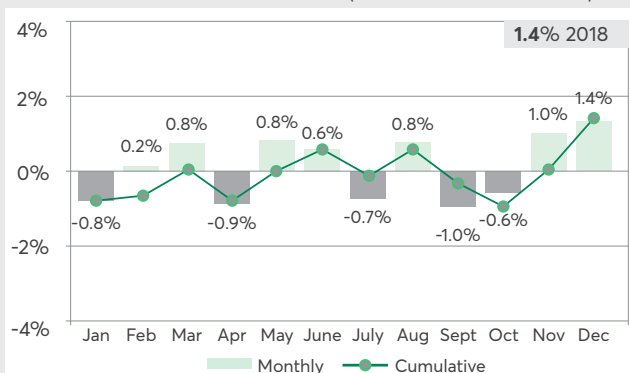
In the U.S., the stock market fell 8.2% during the quarter after a rate hike by the Fed and amid fears of an economic slowdown. Still, the major economic indicators remain positive, and the sooner the partial government shutdown is over, the less likely it is to substantially impact the U.S. economy.

In Europe, the quarter was marked by political tension, with the yellow vest protests continuing in France, the European Commission rejecting Italy's budget, and the U.K. postponing the vote on a Brexit agreement. In light of the first quarterly contraction for the German economy since 2015 and the broader global economic outlook, European stock markets fell 7.8% this quarter.

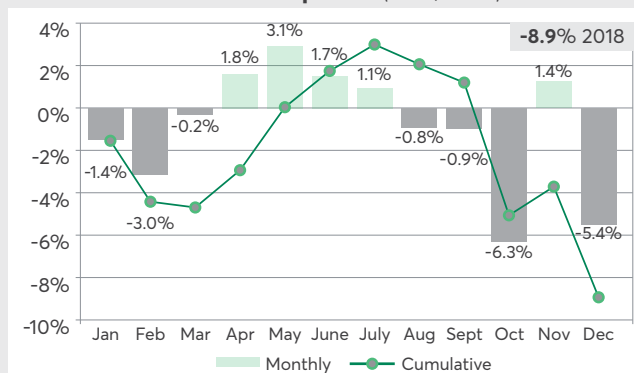
Overall, 2018 was a difficult year for the world's stock markets. Canadian (-8.9%), international (-6.0%) and emerging markets (-6.9%) all ended the year in the red. The only exception was the U.S. stock market, which finished up 4.2% thanks to an appreciating U.S. dollar. Geopolitical uncertainty was a key theme for the year, particularly with the United States waging trade wars with its main trading partners (although Canada and Mexico were spared by the new free-trade agreement). Overall, the global economy remains in expansion, there are still very few signs of weakness in the real economy, and 2018 was a solid year for corporate earnings, with U.S. companies reporting some of the strongest earnings growth since 2010.

Returns – Main Indices

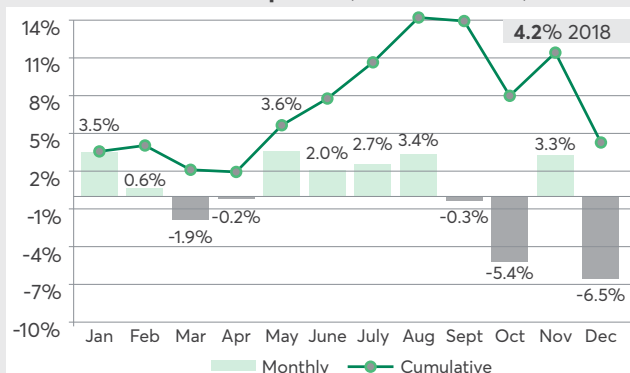
Canadian Fixed Income (FTSE TMX Universe)



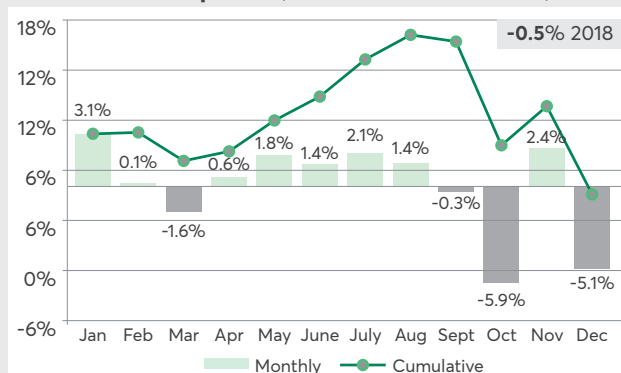
Canadian Equities (S&P/TSX)



American Equities (S&P 500 CAD)



World Equities (MSCI World Net CAD)



Melodia Funds – Performance Review

- All five Melodia Funds recorded negative absolute returns during the fourth quarter of 2018. On a relative basis, all Melodia Funds underperformed their respective benchmarks during the quarter.
- Over the last twelve months, all Melodia Funds generated negative returns and all five funds underperformed their respective benchmarks. Added value ranged between -0.89% and -0.92%.
- The bond component had mixed contributions from allocation to both Canadian and foreign bonds this quarter. Bond funds posted returns between 1.58% (Desjardins Canadian Bond Fund) and -0.66% (Desjardins Global Corporate Bond Fund).
- As for the equity component, all funds posted negative returns. The fund that contributed the most to performance was the Desjardins Emerging Markets Opportunities Fund (-1.32%). The Desjardins Global Small Cap Fund contributed the least (-16.56%).

Gross Rates of Return (%)

December 31, 2018

FUND	Annualized Returns									
	YTD	1 mth	3 mths	1 yr	2 yrs	3 yrs	4 yrs	5 yrs	10 yrs	
0224 Melodia Moderate Growth ¹	-1.24	-0.87	-2.68	-1.24	3.73	4.05	4.26	5.21	N/A	
Benchmark*	-0.32	-0.79	-1.93	-0.32	2.96	3.48	3.92	5.03	N/A	
0226 Melodia Diversified Growth ¹	-1.72	-1.45	-3.72	-1.72	4.33	4.72	4.86	5.75	N/A	
Benchmark*	-0.80	-1.40	-2.95	-0.80	3.29	3.97	4.43	5.53	N/A	
0228 Melodia Balanced Growth ¹	-2.19	-2.02	-4.76	-2.19	4.85	5.17	5.35	6.20	N/A	
Benchmark*	-1.29	-2.01	-3.97	-1.29	3.60	4.42	4.91	6.01	N/A	
0230 Melodia Aggressive Growth ¹	-2.94	-2.89	-6.29	-2.94	5.48	5.89	6.07	6.90	N/A	
Benchmark*	-2.03	-2.93	-5.49	-2.03	4.02	5.05	5.59	6.71	N/A	
0232 Melodia Maximum Growth ¹	-3.43	-3.46	-7.30	-3.43	5.86	6.25	6.49	7.32	N/A	
Benchmark*	-2.53	-3.54	-6.50	-2.53	4.28	5.43	6.03	7.17	N/A	

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

¹ 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.

Composition of the Melodia Funds

FIXED INCOME	CANADIAN EQUITY	FOREIGN EQUITY
Desjardins Short-Term Income		Desjardins American Equity Growth
Desjardins Canadian Bond	Desjardins Canadian Equity Value	Desjardins American Equity Value
Desjardins Enhanced Bond	Desjardins Canadian Equity	Desjardins Overseas Equity Growth
Desjardins Global Corporate Bond	Desjardins Tactical Balanced Fund (Growth portion)	Desjardins Overseas Equity
Desjardins Emerging Markets Bond		Desjardins Global Small Cap Equity
Desjardins Global Inflation Linked Bond		Desjardins Emerging Markets Opportunities
Desjardins Tactical Balanced Fund (Income portion)		Desjardins Tactical Balanced Fund (Growth portion)

A la carte Funds – Performance review

Gross Rates of Return (%)

December 31, 2018

FUNDS	Annualized Returns								
	YTD	1 mth	3 mths	1 yr	2 yrs	3 yrs	4 yrs	5 yrs	10 yrs
FIXED INCOME									
0213 DGIA Money Market ¹	1.76	0.18	0.53	1.76	1.45	1.41	1.36	1.39	1.31
0288 Desjardins Short-Term Income (DGIA)	1.82	0.75	1.12	1.82	1.37	1.54	1.63	1.92	N/A
0289 Desjardins Canadian Bond (DGIA)	1.26	1.30	1.56	1.26	2.02	1.98	2.35	3.65	N/A
0290 Desjardins Enhanced Bond (AllianceBernstein)	0.55	0.97	1.10	0.55	1.76	2.13	2.42	3.73	N/A
0234 Desjardins Global Tactical Bond (PIMCO)	-0.17	0.55	-0.41	-0.17	4.69	6.69	5.01	5.15	N/A
CANADIAN EQUITY									
0343 Desjardins Canadian Equity Income (Lincluden)	-7.60	-3.89	-8.83	-7.60	-1.47	6.16	3.44	5.08	10.53
0292 Desjardins Canadian Equity (DGIA)	-9.68	-5.33	-10.19	-9.68	-2.38	3.81	1.48	3.37	N/A
0208 Desjardins Canadian Small Cap Equity (Fiera) ²	-12.19	-3.81	-16.00	-12.19	-6.26	-0.09	0.38	2.41	N/A
FOREIGN EQUITY									
0331 Desjardins Global Equity Dividend (Epoch)	-1.05	-3.54	-2.63	-1.05	4.38	4.50	6.77	8.69	10.10
0344 Desjardins Global Equity Growth (Baillie Gifford)	-1.14	-4.67	-9.40	-1.14	11.47	8.45	11.24	11.93	14.30
0297 Desjardins Global Small Cap Equity (Lazard)	-13.55	-7.08	-16.57	-13.55	0.27	0.23	5.33	7.64	N/A

Returns including historical returns of underlying funds and/or strategy.

¹ DGIA Management Inc. has managed this fund since November 23, 2012. Between September 2003 and November 2012, the fund was managed by Fiera Capital Corporation.

² Desjardins Investments Inc. has managed this fund since July 13, 2016. Between June 2011 and July 2016, the fund was managed by Fiera Capital Corporation.

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

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 2018

At this time, two underlying mandates composing of the Melodia Funds and two funds from the A la carte funds are being monitored closely:

- The Desjardins Global Inflation Linked Bond Fund, sub-advised by BlackRock, is being monitored because the mandate will be revised in the second quarter of 2019.
- The Desjardins Global Corporate Bond Fund, sub-advised by AllianceBernstein, is being monitored because of its underperformance relative to its benchmark.
- The Desjardins Global Equity Dividend (Epoch) Fund is being monitored due to overall performance below expectations.
- The Desjardins Global Small Cap (Lazard) Fund is being monitored due to overall performance below expectations.

All the other underlying mandates of the Melodia Funds and the A la carte funds 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.

Desjardins Insurance refers to Desjardins Financial Security Life Assurance Company.

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