

## Capital International – Canadian Core Plus Fixed Income

# Quarterly portfolio review and commentary

### Executive summary

- Series A units of the fund ended the second quarter with a gain of 2.30%, while the DEX Universe Bond Index, which tracks Canadian government and corporate bonds, gained 2.93%.
- Government bonds had a strong second quarter, followed by investment-grade corporate bonds, while investors moved away from high-yield debt.
- 72.8% of assets were invested in Canadian bonds, and 94.9% of assets were in Canadian dollars.

Canada's economy remained strong, and in June, the Bank of Canada increased its target for the overnight lending rate to 0.5% from 0.25%.

The Canadian dollar lost ground to the yen and the U.S. dollar, while it rose versus the euro, strengthening nearly 5% over the quarter.

The sovereign debt crisis in Europe caused investors worldwide to seek refuge in higher quality investments. Government bonds, especially U.S. Treasuries, posted solid gains, as did investment-grade corporate bonds, while lower quality corporate bonds stumbled in the second quarter.

### Portfolio review

- The portfolio's primary focus continues to be capital preservation and income generation, although portfolio managers increased exposure to corporate debt somewhat as business conditions improved during the period. Government and provincial bonds made up 70.2% of the portfolio, while investment-grade corporate bonds made up 21.4%, up from 18.5% three months ago.
- The portfolio included bonds from Canada (72.8%); the U.S. (10.8%); Germany (3.8%); the U.K. (2.0%); Denmark (1.2%); and a variety of smaller positions in other countries.
- The Fund's fourth-largest holding, Capital International Fund – CIF Global High Income Opportunities Fund, a Luxembourg-based fund managed by an affiliate of the Fund manager, stood at 7.1% of assets at the end of June, down from 9.2% at the end of December. This underlying fund invests in corporate high-yield and emerging markets bonds from a variety of countries, including the United States, Brazil, Turkey and Mexico. Through this holding, the fund gains exposure to an important source of yield, as well as relative values, since bond markets in the developing world have weathered the recession well.
- Total exposure to the Canadian dollar stood at 94.9%. The fund uses forward currency contracts to manage its exposure to other currencies.

### Long-term perspective

With economic recovery under way in Canada, additional short-term interest rate increases are likely in the second half of 2010. The fund's portfolio managers are prepared to move toward a more defensive interest rate structure if higher yields appear imminent, but long-term rates have remained relatively stable up to this point.

So far, there has been little transmission of European credit problems to North America. Bank lending, levels of trade and signs of economic recovery have been mostly

unaffected, while commodity prices are modestly lower. The fund's portfolio managers continue to hold European government bonds, primarily from Germany, France and the Netherlands, since the prospect of inflation in those countries remains low.

The portfolio's mandate is to provide steady income, capital preservation and long-term total return consistent with prudent management by investing mainly in a broad range of Canadian and global fixed-income securities. This conservative strategy is in keeping with the Capital organization's strengths: managing portfolios based on careful, cautious research with a global focus.

### Portfolio description

Capital International – Canadian Core Plus Fixed Income fund is a broadly diversified bond fund that has the flexibility to invest in investment-grade and below investment-grade bonds on a global basis.

### Investment objective

The objective of the portfolio is to provide steady income, capital preservation and long-term total return consistent with prudent management by investing mainly in a broad range of Canadian and global fixed-income securities.

### Other portfolio characteristics

- A minimum of 50% of assets are invested in Canadian investment-grade bonds as measured at the time of investment.
- May invest in both investment-grade and high-yield securities from issuers in developed and developing countries.
- Uses forward currency contracts to manage the risk of foreign currency fluctuations.

### Portfolio managers

	Years in profession	Years with Capital
Mark A. Brett	31	16
James R. Mulally	34	30

As of December 31, 2009.

Top 10 holdings		
	% of portfolio	Yield
Canada Govt C\$ Bond 5.75% 06/01/29	13.4%	3.6%
Canada Govt C\$ Bond 5.25% 06/01/12	10.8	1.3
Canada Housing Trust C\$ 4.0% 06/15/12	7.9	1.4
CIF Global High Inc Op (CIF-GHIO) Class C US\$	7.1	6.8
Quebec Prov C\$ 9.375% 01/16/23	3.6	4.3
Newfoundland C\$ 5.25% 06/04/14	3.4	2.6
New Brunswick C\$ Deb 6.75% 06/27/17	3.3	3.5
Deutschland Rep Eur 4.25% 07/04/18	2.9	2.3
Canada Housing Trust C\$ 4.10% 12/15/18	2.3	3.5
U.S. Treasury Note 3.875% 02/15/13	2.3	0.8

Portfolio characteristics	
Assets (\$ mil) <sup>1</sup>	\$28.01
Total bond holdings	76
Top 10 bond holdings as % of:	
Capital International – Canadian Core Plus Fixed Income	57.00%
DEX Universe Bond Index	—
Portfolio turnover rate	56.43%
Trading expense ratio	—
Effective duration (years) <sup>2</sup>	5.88
Current yield	4.84%
Yield to work out <sup>3</sup>	3.21%

Asset type <sup>4</sup>	
	% of net assets
Developed markets (investment grade)	
Government	70.2%
Corporate	21.4
Asset backed	0.0
Mortgage backed	0.0
Subtotal	91.6
Corporate high yield	2.4
Emerging market debt <sup>5</sup>	5.1
Cash and cash equivalents	0.9
<b>Total investments</b>	<b>100.0%</b>

Country and currency <sup>4</sup>	
	% of net assets
Top 5 countries	
Canada	72.8%
United States	10.8
Germany	3.8
United Kingdom	2.0
Denmark	1.2
Top 5 currencies (hedged)	
Canadian dollar	94.9%
Mexican peso	0.9
South Korean won	0.7
Polish zloty	0.7
U.S. dollar	0.6

<sup>1</sup> For combined series.

<sup>2</sup> Includes the impact of callable bonds. Duration is a measure of the approximate sensitivity of a bond portfolio's value to interest rate changes.

<sup>3</sup> Reflects the yield to maturity or end date (puts, calls, etc.) for each bond held in the portfolio.

<sup>4</sup> Includes the Fund's direct portfolio holdings as well as the holdings through the CIF Global High Income Opportunities fund.

<sup>5</sup> May also include a portion of investment-grade issues.

Total returns (%) as of June 30, 2010													
Series	Cumulative			Annualized					Calendar year				
	3 mo	YTD	1 yr	2 yr	3 yr	4 yr	5 yr	Since inception*	2009	2008	2007	2006	2005
A	2.30	3.44	5.82	5.30	—	—	—	4.74	1.93	—	—	—	—
B	2.20	3.23	5.38	4.89	—	—	—	4.32	1.51	—	—	—	—
F	2.43	3.69	6.33	5.84	—	—	—	5.26	2.43	—	—	—	—
H	2.46	3.75	6.43	5.94	—	—	—	5.36	2.54	—	—	—	—

\*The fund's inception date is April 30, 2008.

Asset type changes		Country changes		Currency changes	
Since June 30, 2009	% of net assets	Since June 30, 2009	% of net assets	Since March 31, 2010	% of net assets
Largest increase:		Largest increase:		Largest increase:	
Corporate	9.1%	Canada	1.4%	Canadian dollar	1.3%
Largest decrease:		Largest decrease:		Largest decrease:	
Government	-9.8%	Denmark	1.1	South Korean won	0.7
		Germany	0.8	Mexican peso	0.4
		Italy	-2.3%	Euro	-1.1%
		United States	-2.4	Swedish krona	-0.7
		United Kingdom	-0.7	Australian dollar	-0.7

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Unless otherwise indicated, data as of June 30 2010.

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