



MONTHLY FIXED INCOME UPDATE

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Interest Rate Summary	Dec-30-22	Nov-30-22	Oct-31-22	Sep-29-22	Aug-31-22	Jul-29-22	Jun-30-22	Dec-31-21	Dec-31-20
U.S.									
3-Month T-Bill	4.37%	4.35%	4.07%	3.30%	2.93%	2.36%	1.67%	0.04%	0.08%
2-Year Treasury	4.43%	4.31%	4.49%	4.28%	3.50%	2.89%	2.96%	0.73%	0.12%
10-Year Treasury	3.88%	3.61%	4.05%	3.83%	3.20%	2.65%	3.02%	1.51%	0.92%
Canada									
3-Month T-Bill	4.24%	3.99%	3.85%	3.78%	3.23%	2.65%	2.09%	0.17%	0.06%
2-Year Canada	4.05%	3.87%	3.89%	3.79%	3.65%	2.96%	3.09%	0.95%	0.20%
10-Year Canada	3.30%	2.94%	3.25%	3.17%	3.12%	2.61%	3.22%	1.42%	0.68%

Performance	2022	2021	2020	2019	2018	2017	2016
DEX Universe Bond Index	-11.69%	-2.54%	8.68%	6.87%	1.41%	2.52%	3.52%
DEX Federal Bond Index	-9.34%	-2.62%	7.28%	3.73%	2.39%	0.13%	3.66%
DEX Provincial Bond Index	-15.05%	-3.28%	9.86%	9.07%	0.66%	4.33%	4.14%
DEX All Corporate Index	-11.54%	-1.34%	8.74%	8.05%	1.10%	3.38%	2.71%
DEX "A" Corporate Index	-9.87%	-2.30%	8.98%	9.65%	0.51%	4.42%	2.62%
DEX Real Return Bonds	-14.32%	1.84%	13.02%	8.02%	-0.05%	0.72%	2.79%
DEX High Yield Bonds	-5.44%	6.18%	6.69%	8.48%	2.15%	5.20%	13.79%

Comments

After falling in November, bond yields moved progressively higher in December with the bellwether 10-year U.S. note closing the year at 3.88%, up 27 basis points for the month and a whopping 227 basis points for the year. In December, once again, forecasts of potential relaxation of monetary tightness were dashed by consistent hawkish comments from the Fed after they hiked rates a further 50 basis points. The December employment report was robust and recent inflation reports, while demonstrating some improvement, remained at elevated levels.

A key catalyst driving bond yields higher was the announcement on December 20 by the Bank of Japan that it was broadening the acceptable range for 10-year Japanese Government bonds from 0.25% to 0.50%. Japan was the lone global holdout from monetary tightening. U.S. bond yields tacked on 20 basis points until year end as traders feared that Japanese investors would turn to domestic bonds instead of U.S. bonds.

So far this month, bond yields have moved steadily lower by approximately 35 basis points for the 10-year as recession forecasts dominated, along with optimism for an imminent improvement in inflation. This occurred despite more hawkish comments from the Fed stating they would likely push the Funds Rate above 5%. Market participants are increasingly challenging the Fed's stance.

As yields have dropped, corporations are piling onto the bond market, raising some \$58 billion in the first two weeks of the year. Corporate yield spreads, both investment grade and high yield, remain well behaved, belying recession forecasts.

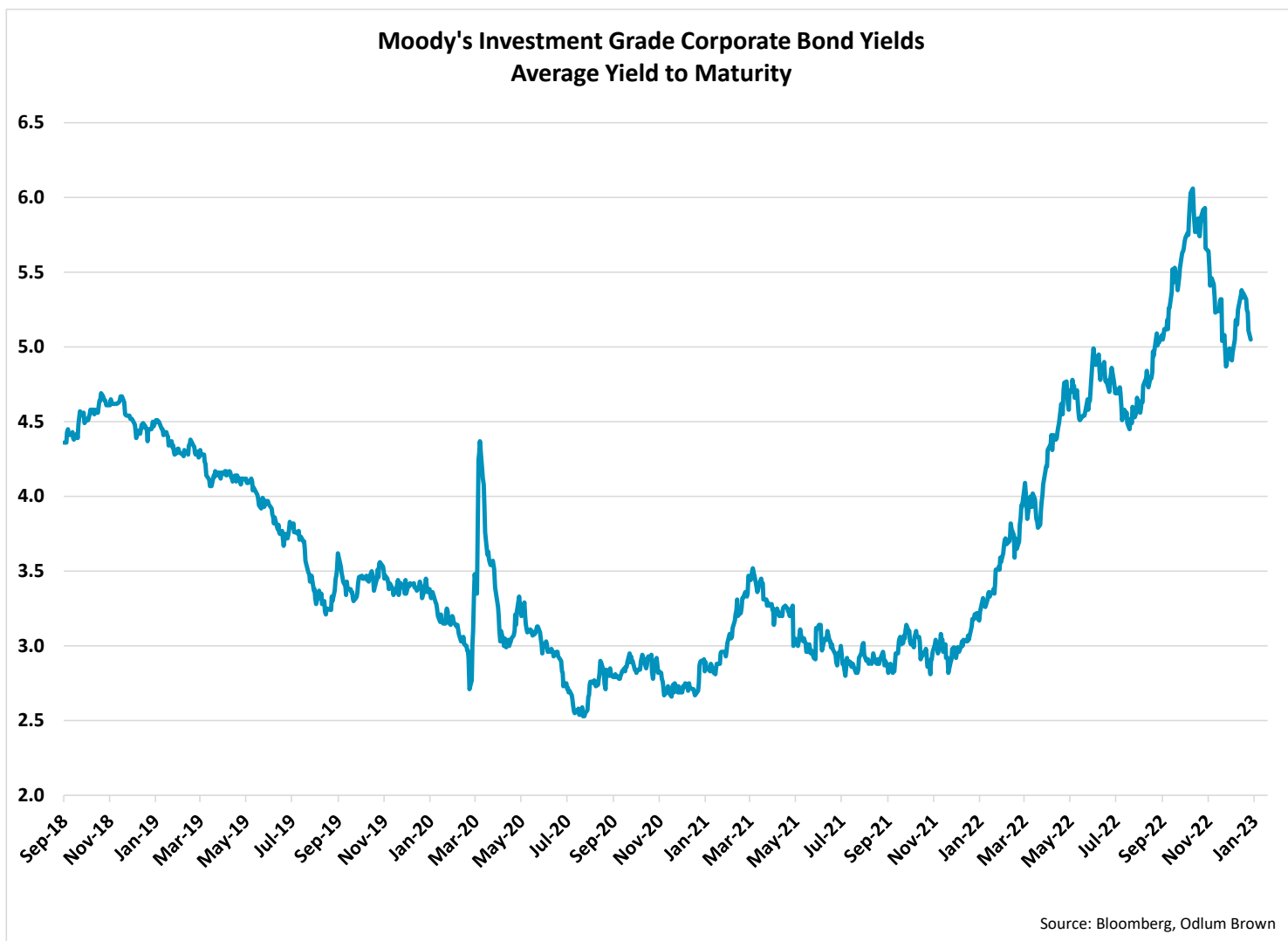
The Bank of Canada added 50 basis points to its rate on December 7. While pundits expect it to pause, the bank threw cold water on that thought.

U.S. 10-Year Treasury

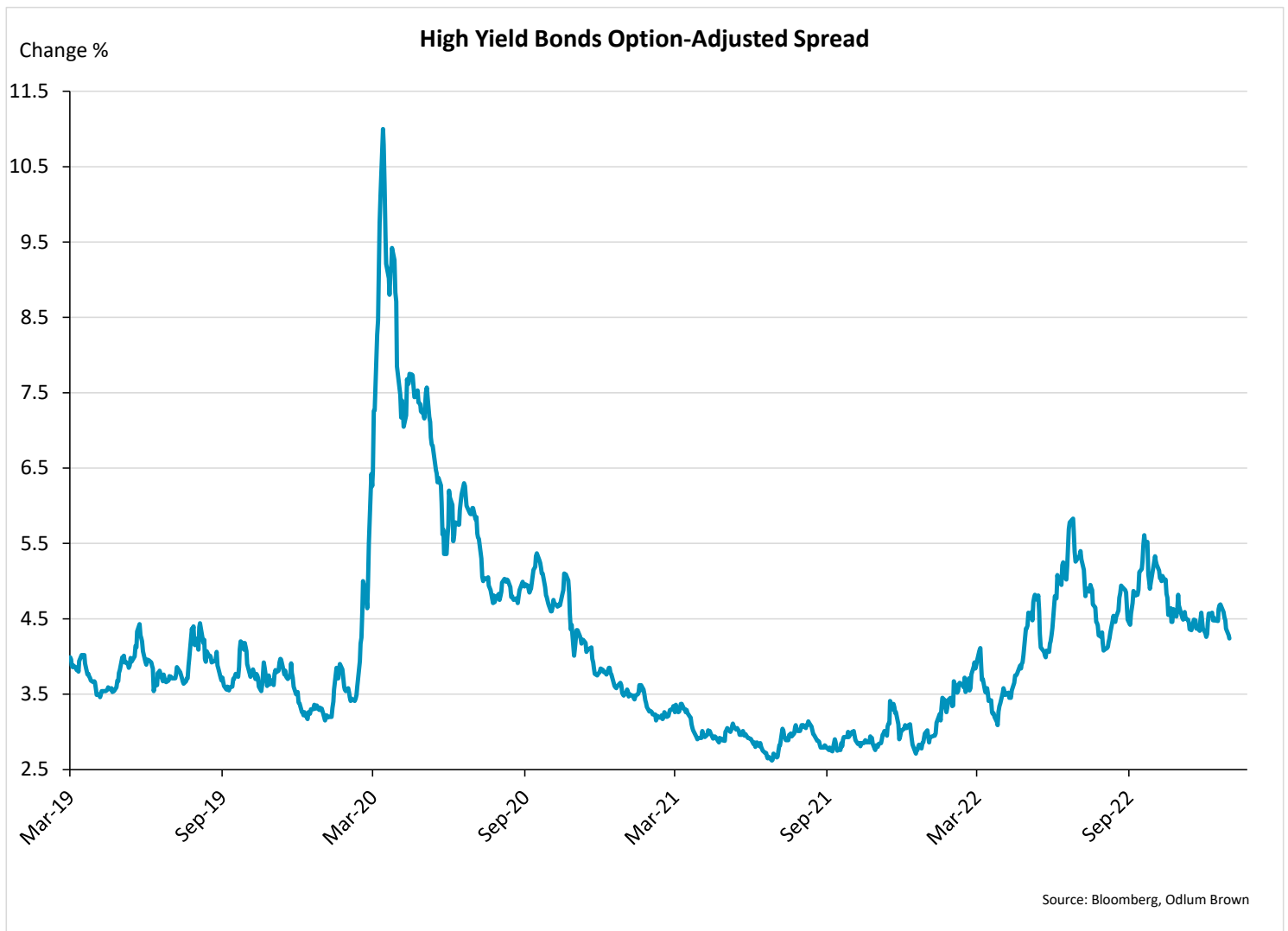
Yield (%)



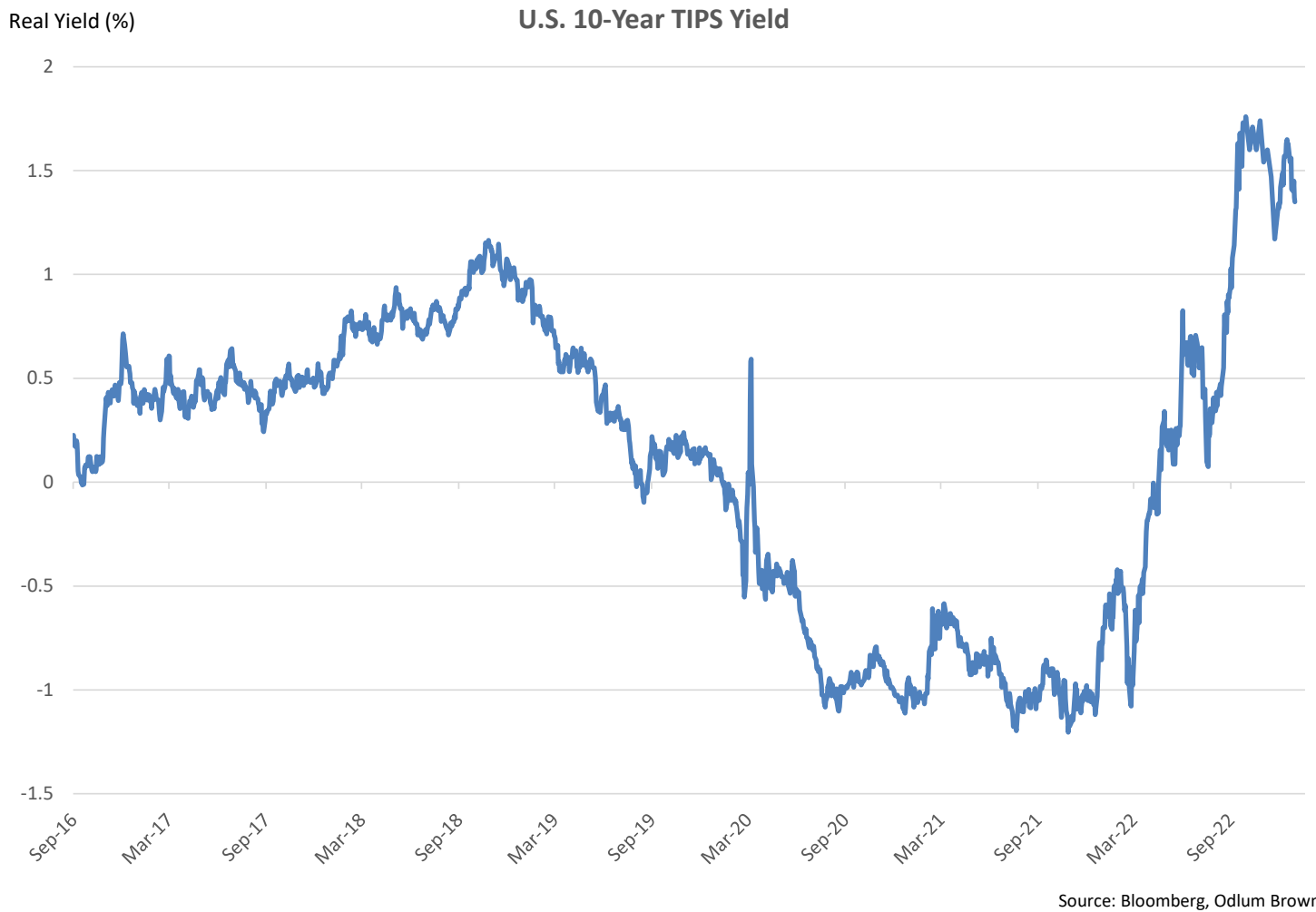
This bellwether's yield has been volatile reaching 4.25%, which is well above the previous resistance point of 3.25%. This bond has fallen 75 basis points from the peak and is within 25 basis points of major resistance.



Corporate bond markets remain calm. Investment-grade corporate yields have maintained a relatively steady spread from government bonds.



High yield bonds have performed well, with spreads narrowing significantly from their summer peak.



After being mired in negative territory, real yields have responded to monetary tightening by moving higher. Recently, their yield has tracked lower with nominal yields.

Outlook

The predominant belief among market participants is that inflation will decelerate rapidly, the Fed will stop hiking rates and there is a recession coming. Thus far, inflation has eased for three straight months, with the services component of CPI being the biggest contributor to still elevated inflation. For its part, the Fed, via different pronouncements, indicated that more hikes are to come, with the Fed Funds Rate going to at least 5%. It is likely, however, that hikes of only 25 basis points are in the cards. As to the recession, weakness is spreading in the economy, beyond what we're seeing in housing. Manufacturing is weak and consumer confidence is sliding. Thus far, however, the employment market remains taut, with continued growth in non-farm payrolls, a lower unemployment rate and solid wage gains.

Last year was grueling for fixed income investors, the worst ever for performance. The coming year should witness a return to positive performance, perhaps in the range of 4% to 7%. This outlook is based on a peaking in central bank tightening plus steady improvement on the inflation front. To be sure, inflation remains in the forefront, and wage increases could limit improvement. Central bank rates will stay elevated with no easing likely in all of 2023.

The yield curve will remain inverted for the foreseeable future. In the meantime, fixed income investors will be able to earn 5% plus on short-duration bonds, thus producing positive returns with minimal risk to principal.

There are obstacles to this consensus forecast. Wage increases may continue to act as a floor on inflation. Fiscal stimulus from the U.S. will produce a total of \$2 trillion dollars to be borrowed from the bond market. A third possibility is that energy inflation could surprise on the upside.

In summary, there will be more chapters in the bond market drama and we expect a wide trading range of 3.25% to 4.25% on the U.S 10-year Treasury bond.

Strategy

Inflation is the enemy of bonds and will remain a major negative for the foreseeable future. This remains a time to defend principal.

We advocate the use of floating rate debentures, whose coupons are now above 5% and should stay there as central banks are likely to pause. In combination with a one- to five-year corporate ladder, returns should be positive.

This year's increase in corporate yields has resulted in a host of bonds, issued at lower yields, trading at significant discounts from their par values, thus creating positive after-tax opportunities. We have created the **Odium Brown Discount Corporate Ladder** portfolio to take advantage of this opportunity.

We are potentially approaching the end of the monetary-tightening cycle, producing a peak Fed Funds Rate of at least 5%. Thus, some modest increase in duration may be in order, which can be achieved by adding three- to five-year bonds to existing ladders, if they are not already held.

We also recommend using the **Odlum Brown Corporate Bond Ladder**, which features more current coupon bonds in combination with individual floating rate bonds. The **Odlum Brown Model Portfolio** is well positioned for this market environment with a short duration and floating rate debentures included.

We have adopted the use of outside bond investment managers to augment returns. Our top recommended funds are:

- **Picton Mahoney Liquid Alt Fund.** This is a well-managed long/short fund and is available as an ETF.
- **Canso Short-Term and Floating Rate Fund.** This fund protects principal and takes advantage of opportunities in the floating rate market.
- **Canso Corporate Value Fund.** This is a well-managed, long-only corporate bond fund.

Please consult your Investment Advisor or Portfolio Manager for more details and to discuss this strategy.

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