



MONTHLY FIXED INCOME UPDATE

Hank Cunningham

December 20, 2021

| Interest Rate Summary | Nov-30-21 | Oct-29-21 | Sep-29-21 | Aug-31-21 | Jul-30-21 | Jun-30-21 | May-31-21 | Dec-31-20 |
|-----------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| U.S. | | | | | | | | |
| 3-Month T-Bill | 0.05% | 0.05% | 0.04% | 0.04% | 0.04% | 0.04% | 0.01% | 0.08% |
| 2-Year Treasury | 0.57% | 0.50% | 0.28% | 0.21% | 0.19% | 0.25% | 0.14% | 0.12% |
| 10-Year Treasury | 1.45% | 1.56% | 1.49% | 1.31% | 1.22% | 1.46% | 1.60% | 0.92% |
| Canada | | | | | | | | |
| 3-Month T-Bill | 0.06% | 0.15% | 0.13% | 0.16% | 0.17% | 0.14% | 0.11% | 0.06% |
| 2-Year Canada | 0.98% | 1.09% | 0.53% | 0.42% | 0.45% | 0.45% | 0.32% | 0.20% |
| 10-Year Canada | 1.57% | 1.72% | 1.51% | 1.21% | 1.20% | 1.39% | 1.48% | 0.68% |

Performance

| | YTD | 2020 | 2019 | 2018 | 2017 | 2016 | 2015 |
|---------------------------|--------|--------|-------|--------|-------|--------|--------|
| DEX Universe Bond Index | -4.14% | 8.68% | 6.87% | 1.41% | 2.52% | 3.52% | 3.52% |
| DEX Federal Bond Index | -3.76% | 7.28% | 3.73% | 2.39% | 0.13% | 3.66% | 3.66% |
| DEX Provincial Bond Index | -5.38% | 9.86% | 9.07% | 0.66% | 4.33% | 4.14% | 4.14% |
| DEX All Corporate Index | -2.80% | 8.74% | 8.05% | 1.10% | 3.38% | 2.71% | 2.71% |
| DEX "A" Corporate Index | -3.97% | 8.98% | 9.65% | 0.51% | 4.42% | 2.62% | 2.62% |
| DEX Real Return Bonds | -1.74% | 13.02% | 8.02% | -0.05% | 0.72% | 2.79% | 2.79% |
| DEX High Yield Bonds | 5.79% | 6.69% | 8.48% | 2.15% | 5.20% | 13.79% | -5.58% |

Comments:

Bond yields rose steadily in November, challenging the yearly high of 1.74% for the ten-year U.S. note. Then, the new variant hit the world and the ensuing risk-off trade drove this bond as low as 1.35% in early December, before rebounding to 1.40%.

The Federal Reserve Board Chair Powell upset markets with a somewhat hawkish statement.

Meanwhile, economic conditions remain robust and labour markets have become extremely tight with a widespread shortage of workers prevalent.

Canada reported a blockbuster employment report, with 154,000 net new employment, almost four times the consensus. The unemployment rate plunged to 6%. This was followed by a \$2 billion trade surplus.

The corresponding U.S. employment report was not as robust but solid nonetheless. Its the unemployment rate fell to 4.2% with over 11 million jobs vacant.

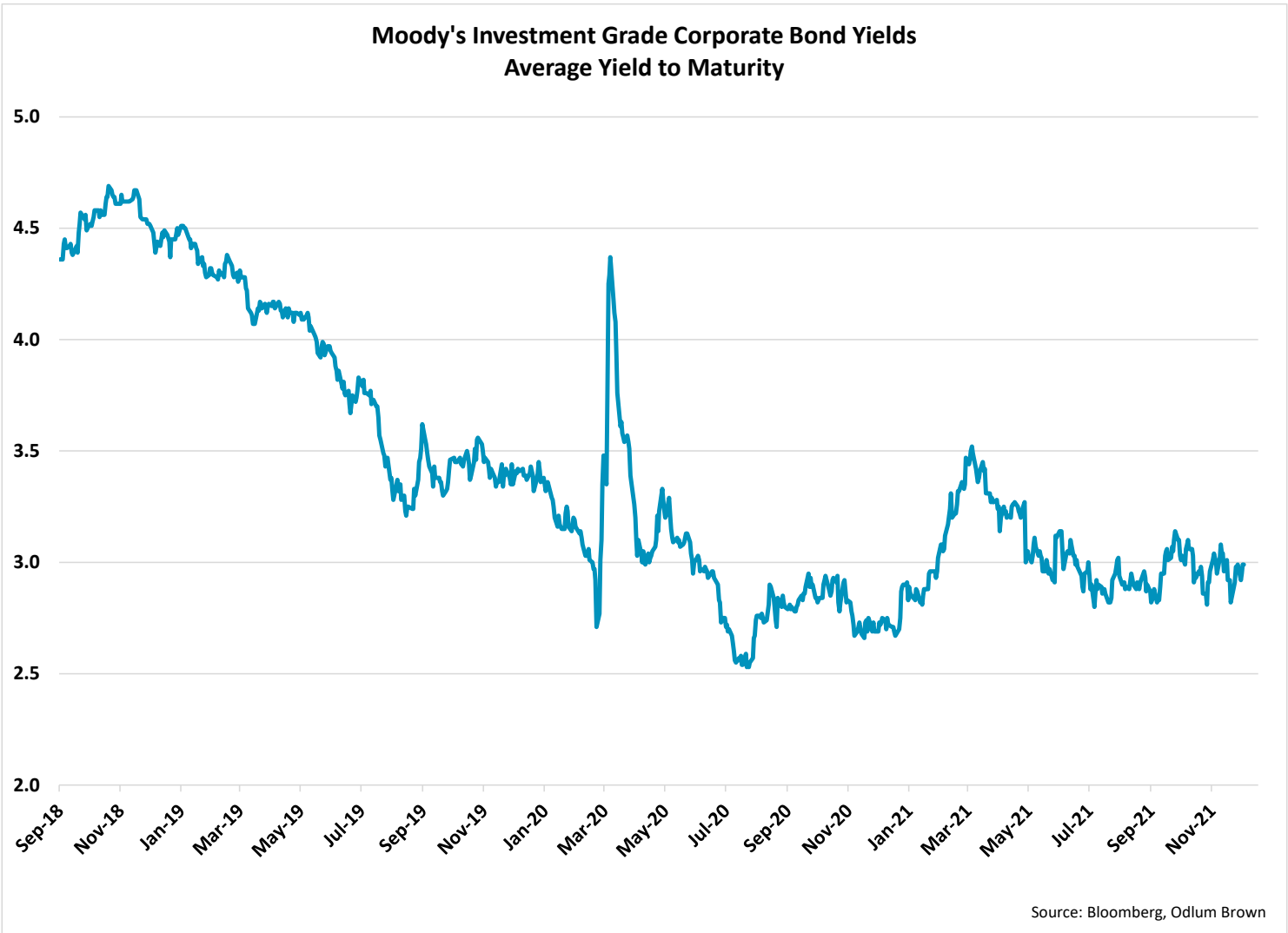
On the flip side of this labour market strength has been the surge in inflation. While there is general agreement that supply chain issues are partly to blame, even the Fed now admits that this bout of inflation is not transitory and will thus persist longer than anticipated. Canada’s year-over-year headline CPI hit 4.7% while that of the U.S. hit a 39-year high of 6.8%.

U.S. 10-Year Treasury

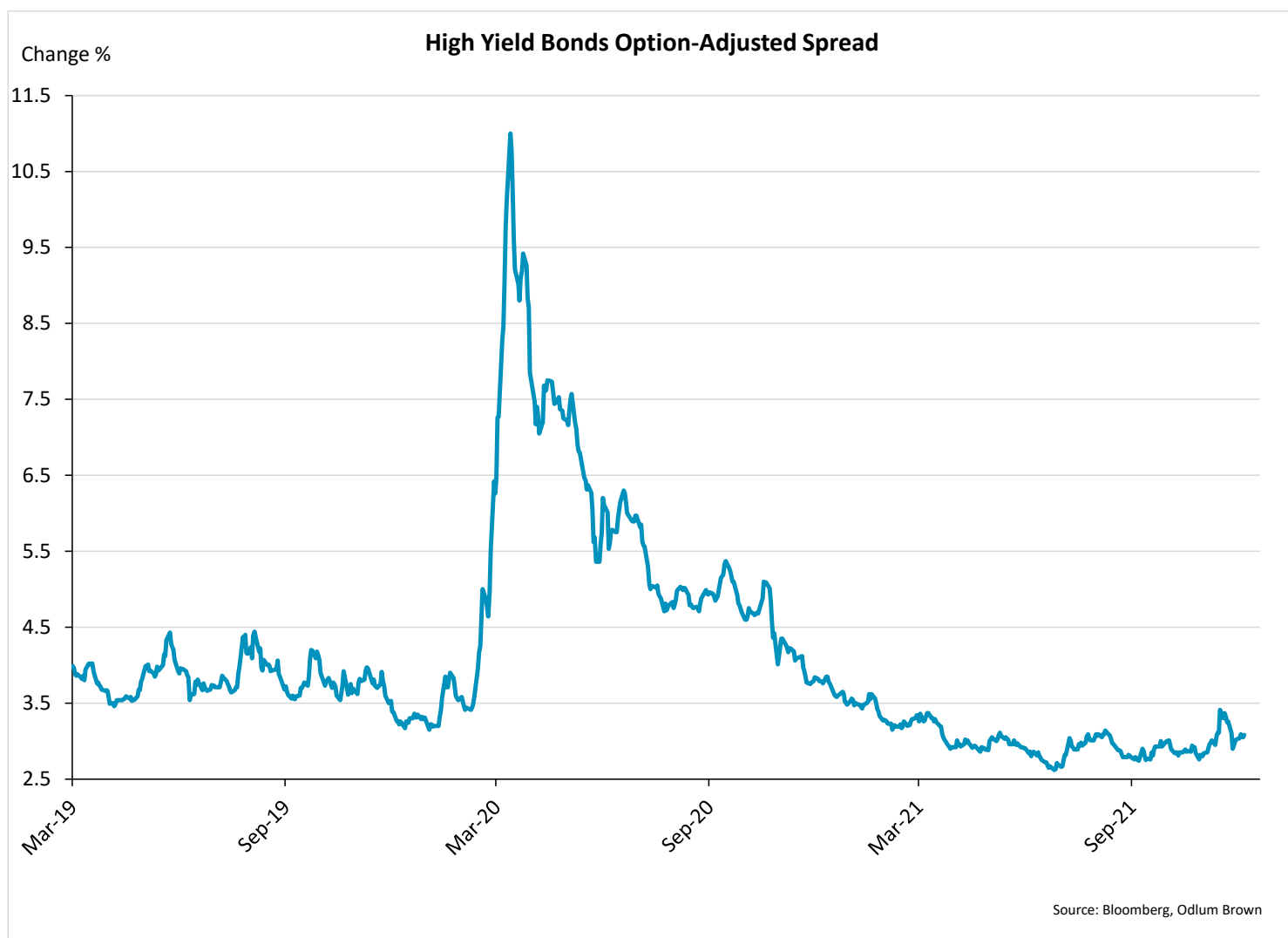
Yield (%)



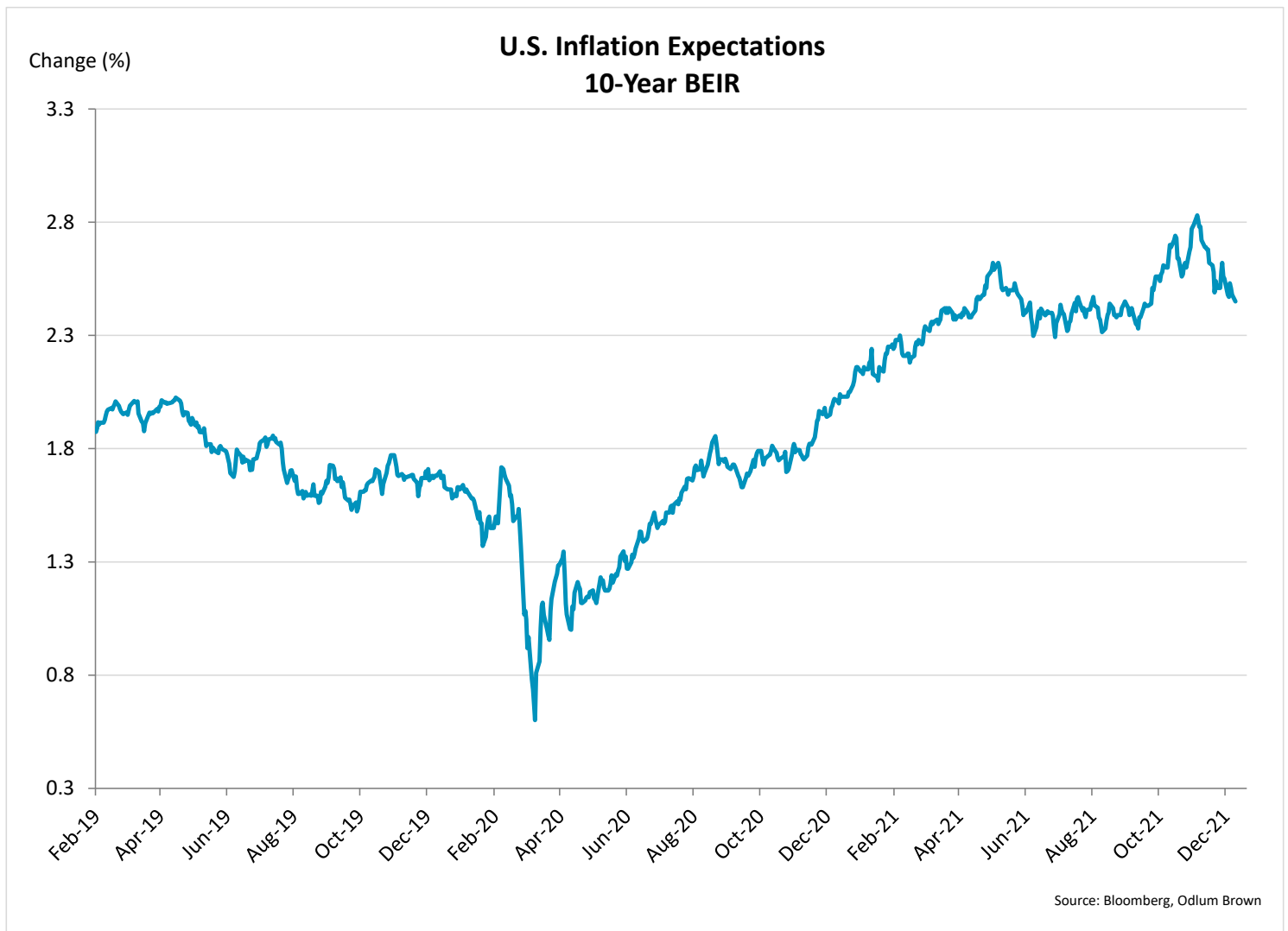
This benchmark’s yield approached its yearly high in November, but has since tumbled to 1.40%, mostly owing to the latest Omicron variant, which is threatening global growth.



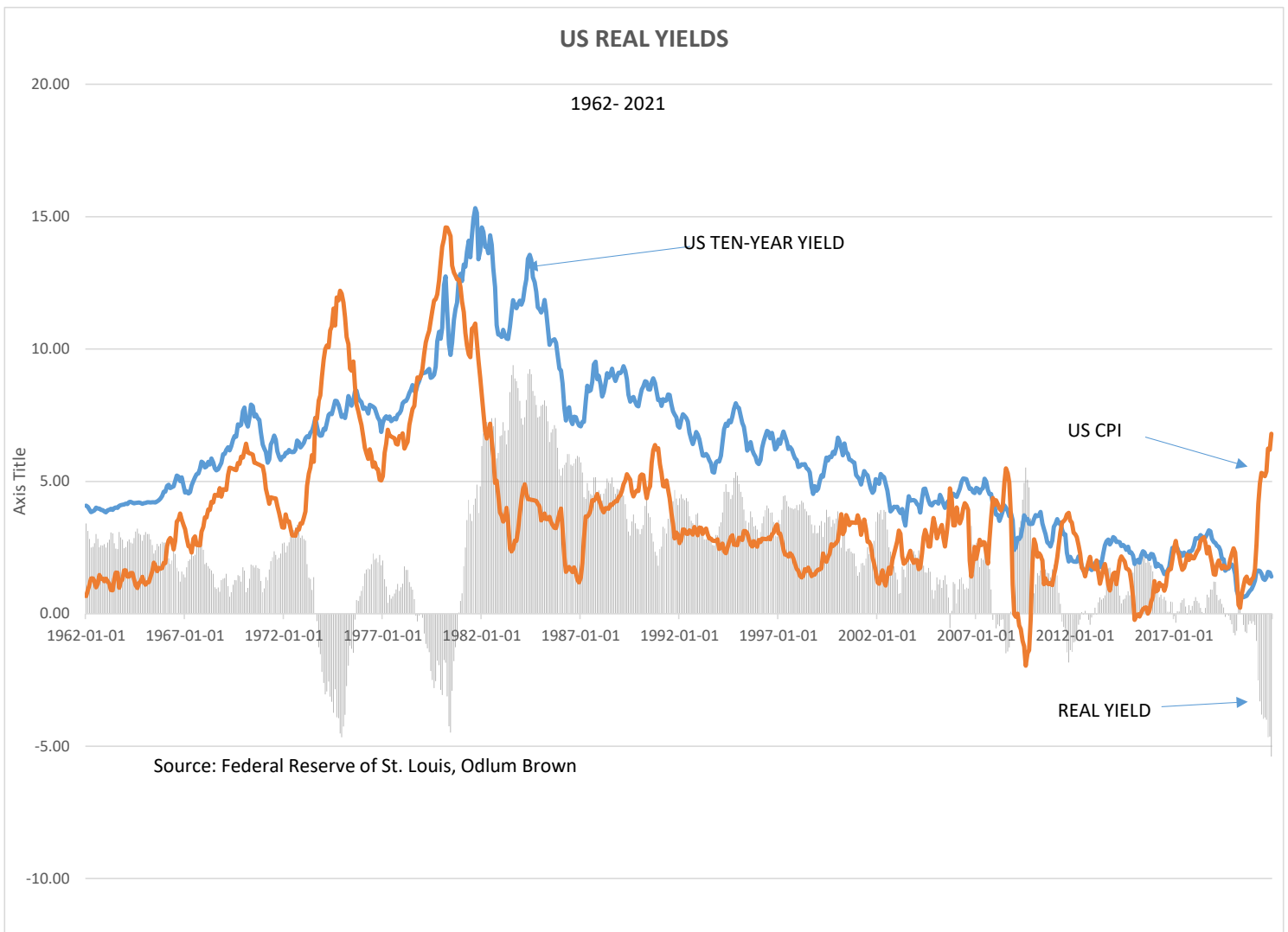
Investment-grade corporate bond yields have widened from record tight spreads .



Demand for high-yield bonds remains robust although spreads have widened modestly from record lows.



Inflation expectations peaked in mid-November before sliding more than 25 basis points, but remaining at elevated levels.



This chart displays the trend in real yields for the past 60 years. There have been several periods of negative yields with current negative yields at their most extreme during this period. The average for this period is positive 2.2%.

Outlook

While the Federal Reserve Board has signaled that it will end its bond-purchasing program in early 2022 and will follow that with as many as three hikes in the Federal Funds Rate, long-term bond yields have fallen, creating a flatter yield curve in the process. Even the Fed has acknowledged that the recent surge in inflation is not transitory. There appears to be a consensus that the easing of supply-chain snarls may lead to a subsiding of headline inflation. However, the extraordinary tightness in the labour market is beginning to manifest itself into increases in wages. If this becomes a trend, it should translate into elevated inflation for longer.

The recent variant outbreak may affect global economic growth, but for now, conditions are vibrant.

It is unlikely that long-term bond yields will resume their uptrend in the short run. Thus, the “lower for longer” argument remains alive and well. Investors may look to benefit from rising short-term yields. Since September, anticipating some tightening by the Fed, U.S. two-year yields have leaped by 40 basis points, while the ten-year has risen only marginally.

Central Banks are in line with the Fed. The Bank of England has raised its key rate, while the Bank of Canada is not far behind. Thus, it appears likely that we will have multiple rate hikes in 2022, with some moderation in inflation.

Fixed income investors will continue to be frustrated by the poor returns available in the bond market.

Strategy

This is a time to defend principal in the bond market as investing in long-term bonds, which, while offering higher nominal yields than shorter-term bonds, carry significant capital loss potential for any rise in long-term yields. Thus, we counsel investors not to reach for yield, but instead to invest in short-term, high-quality corporate bonds. This approach will defend principal while producing modest returns.

Specifically, we recommend a laddered approach using the **Odlum Brown Corporate Bond Ladder**. GICs could be used in the ladder as well. In addition, we adopted the use of outside bond investment managers to augment returns. We continue to do so. 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.

Please read our Odlum Brown Limited Disclaimer and Disclosure - It is important!

Odlum Brown Limited is an independent, full-service investment firm focused on providing professional investment advice and objective research. We respect your right to be informed of relationships with the issuers or strategies referred to in this report which might reasonably be expected to indicate potential conflicts of interest with respect to the securities or any investment strategies discussed or recommended in this report. We do not act as a market maker in any securities and do not provide investment banking or advisory services to, or hold positions in, the issuers covered by our research. Analysts and their associates may, from time to time, hold securities of issuers discussed or recommended in this report because they personally have the conviction to follow their own research, but we have implemented internal policies that impose restrictions on when and how an Analyst may buy or sell securities they cover and any such interest will be disclosed in our report in accordance with regulatory policy. Our Analysts receive no direct compensation based on revenue from investment banking services. We describe our research policies in greater detail, including a description of our rating system and how we disseminate our research, on the Odlum Brown Limited website.

This report has been prepared by Odlum Brown Limited and is intended only for persons resident and located in all the provinces and territories of Canada, where Odlum Brown Limited's services and products may lawfully be offered for sale, and therein only to clients of Odlum Brown Limited. This report is not intended for distribution to, or use by, any person or entity in any jurisdiction or country including the United States, where such distribution or use would be contrary to law or regulation or which would subject Odlum Brown Limited to any registration requirement within such jurisdiction or country. As no regard has been made as to the specific investment objectives, financial situation, and other particular circumstances of any person who may receive this report, clients should seek the advice of a registered investment advisor and other professional advisors, as applicable, regarding the appropriateness of investing in any securities or any investment strategies discussed or recommended in this report.

This report is for information purposes only and is neither a solicitation for the purchase of securities nor an offer of securities. The information contained in this report has been compiled from sources we believe to be reliable, however, we make no guarantee, representation or warranty, expressed or implied, as to such information's accuracy or completeness. All opinions and estimates contained in this report, whether or not our own, are based on assumptions we believe to be reasonable as of the date of the report and are subject to change without notice.

Please note that, as at the date of this report, the Research Analyst responsible for the recommendations herein, associates of such Analyst and/or other individuals directly involved in the preparation of this report hold securities of some of the issuer(s) referred to directly or through derivatives.

No part of this publication may be reproduced without the express written consent of Odlum Brown Limited. Odlum Brown Limited is a Member of the Canadian Investor Protection Fund.