



MONTHLY FIXED INCOME UPDATE

Hank Cunningham

December 19, 2023

Interest Rate Summary	Nov-30-23	Oct 31-23	Sep 29-23	Aug 31-23	Jul 31-23	Jun 30-23	May 31-23	Apr 28-23	Mar-31-23
U.S.									
3-Month T-Bill	5.39%	5.47%	5.45%	5.45%	5.42%	5.30%	5.40%	5.06%	4.75%
2-Yr Treasury	4.68%	5.09%	5.05%	4.87%	4.88%	4.90%	4.41%	4.00%	4.03%
10-Yr Treasury	4.33%	4.93%	4.57%	4.11%	3.96%	3.84%	3.65%	3.43%	3.47%
Canada									
3-Month T-Bill	5.02%	5.02%	5.11%	5.12%	5.04%	4.91%	4.64%	4.43%	4.38%
2-Year Canada	4.19%	4.64%	4.87%	4.64%	4.67%	4.58%	4.22%	3.65%	3.73%
10-Year Canada	3.55%	4.06%	4.02%	3.56%	3.50%	3.27%	3.19%	2.84%	2.90%

Performance	YTD*	2022	2021	2020	2019	2018	2017
DEX Universe Bond Index	3.36%	-11.69%	-2.54%	8.68%	6.87%	1.41%	2.52%
DEX Federal Bond Index	2.30%	-9.34%	-2.62%	7.28%	3.73%	2.39%	0.13%
DEX Provincial Bond Index	3.27%	-15.05%	-3.28%	9.86%	9.07%	0.66%	4.33%
DEX All Corporate Index	5.04%	-11.54%	-1.34%	8.74%	8.05%	1.10%	3.38%
DEX "A" Corporate Index	4.98%	-9.87%	-2.30%	8.98%	9.65%	0.51%	4.42%
DEX Real Return Bonds	-1.26%	-14.32%	1.84%	13.02%	8.02%	-0.05%	0.72%
DEX High Yield Bonds	6.49%	-5.44%	6.18%	6.69%	8.48%	2.15%	5.20%

*As of November 29, 2023

Comments

After peaking at 5% on October 19, the U.S. 10-year note has mounted a spectacular rally, ending October at 4.93%, closing November at 4.33% and now yielding 3.90%. This has been one of the biggest rallies in bond market history over a short period.

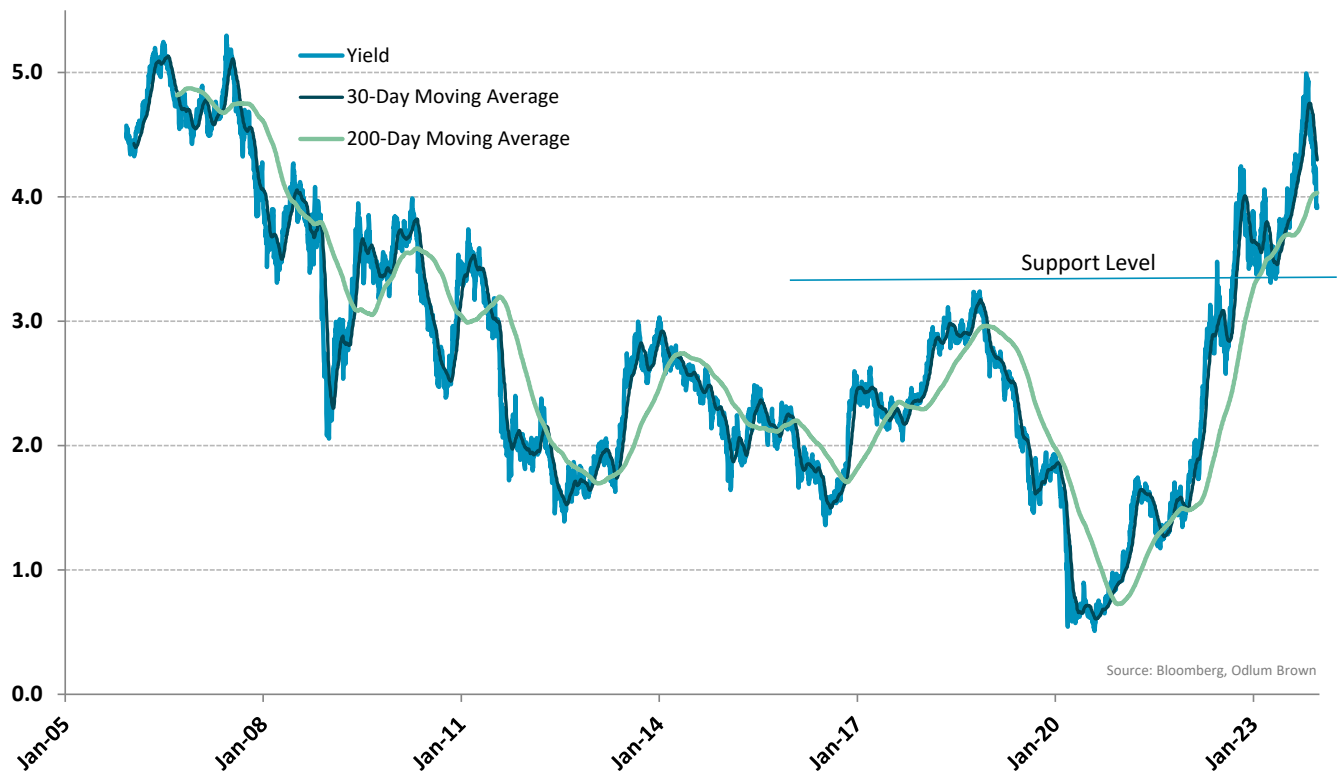
Two major factors drove this rally: a cooling economy and moderating inflation. Market enthusiasm that the Fed was not only done tightening but would signal an ease in its heretofore hawkish stance also pushed bond prices higher.

On December 13, markets got their wish as the Fed emerged from its FOMC meeting with unexpected dovish comments, indicating not only that it was likely done tightening but also that it foresaw three reductions in the Fed Funds Rate in 2024. The bond market soared with yields falling all along the yield curve. Canadian yields followed with our 10-year bond hitting 3.20%. Further buttressing this rally was the Bank of Japan's decision to not tighten monetary policy, as had been widely feared.

Despite signs of a cooling economy, corporate bond spreads, both investment-grade and high-yield, remained near their tightest spreads of the year. The dramatic decline in American yields led to a selloff in the U.S. dollar and the Canadian dollar rallied as a result.

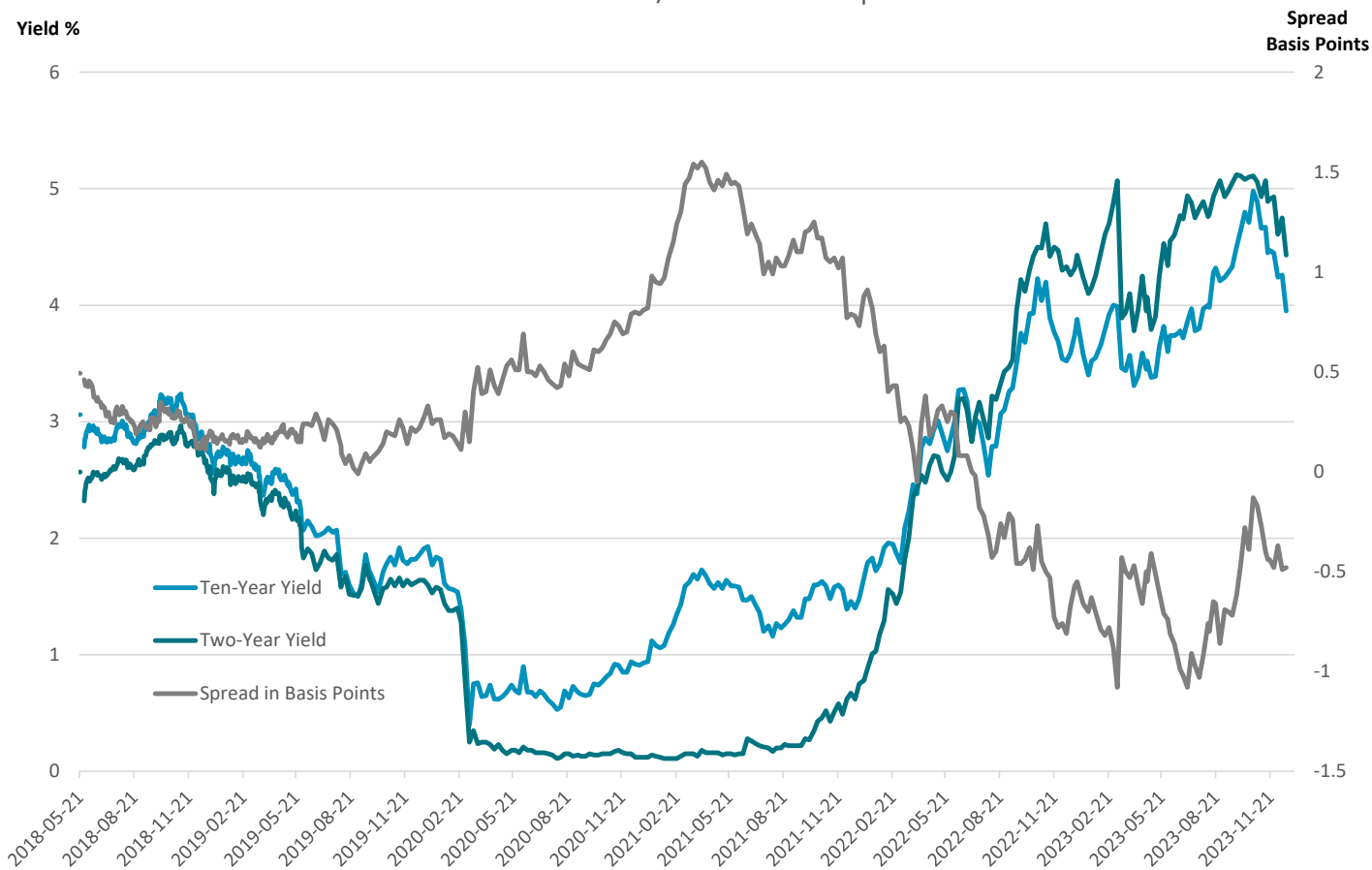
U.S. 10-Year Treasury

Yield (%)



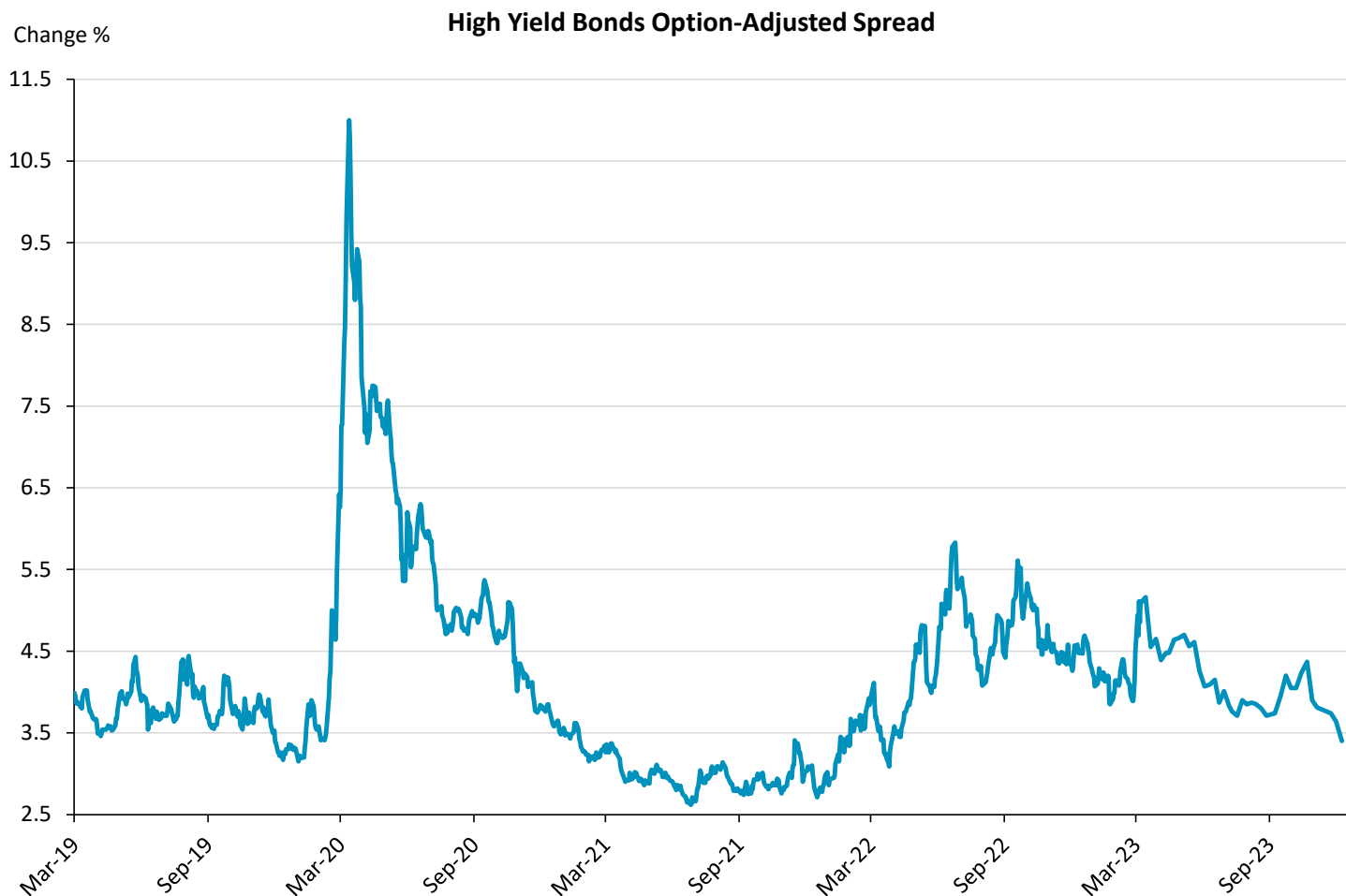
After reaching a 16-year high of 5%, this bond has plunged to 3.90% and is below its 200-day moving average.

U.S. Two-Year / Ten-Year Yield Spread



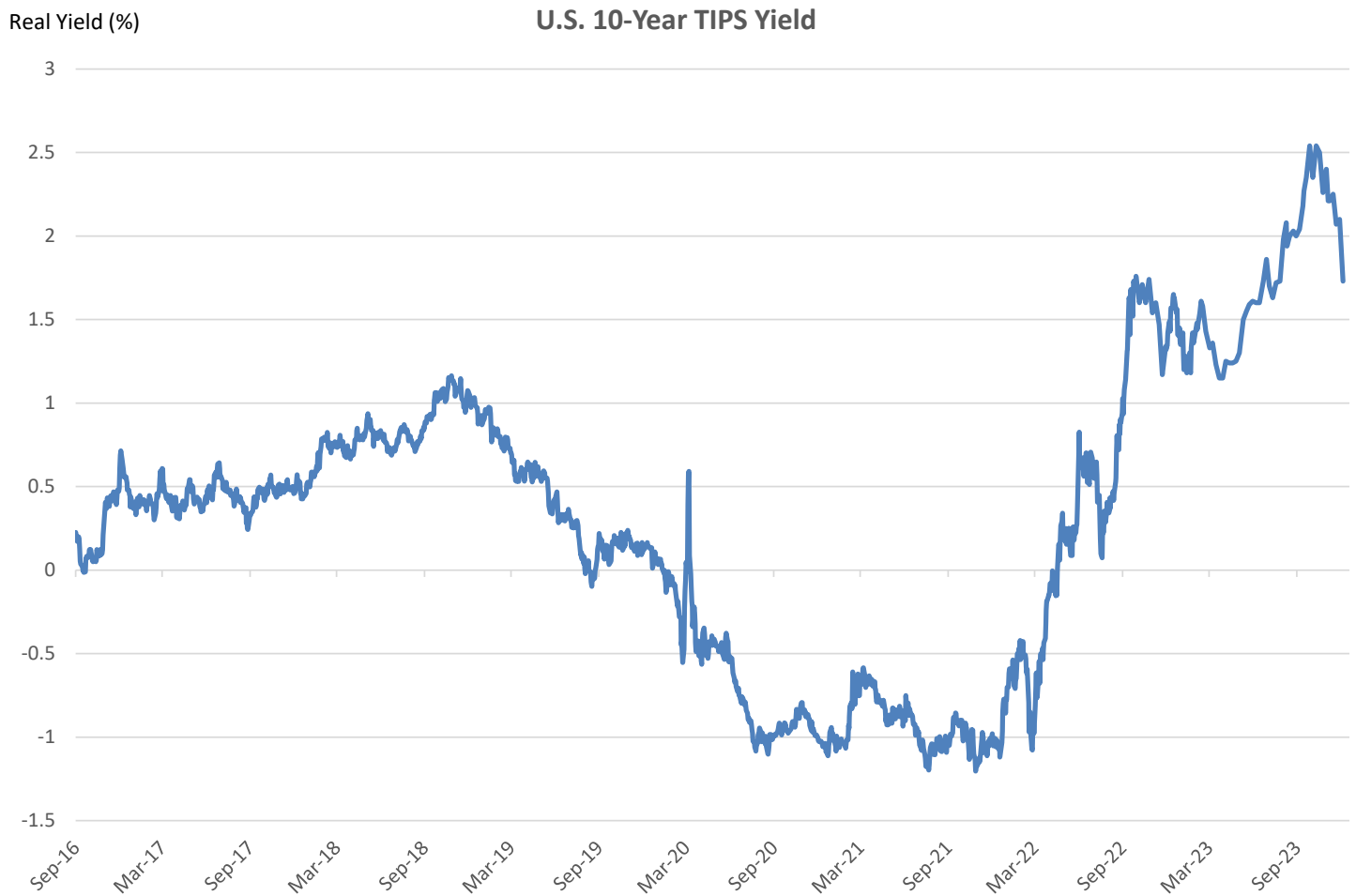
Source: Bloomberg, Odium Brown

The yield curve remains inverted. Of note, the inversion moved close to zero before steepening again.



Source: Bloomberg, Odium Brown

High yield bond spreads remain near their lows for the past year.



Source: Bloomberg, Odium Brown

Real yields have plummeted along with nominal yields.

Outlook

Despite the efforts of several Fed speakers to cool the enthusiasm for rate reductions in early 2024, the bond market remains firm and has priced in 150 basis points of Fed Funds decreases by mid-2024. The Fed did point out that it had no intention of ending its quantitative tightening program and it also highlighted that it is paying close attention to inflation.

Canada faces a weaker economy, teetering on recession and yet our inflation progress has been halting. The Bank of Canada is nowhere near as dovish as the Fed. Other central banks are monitoring their inflation rates and economies closely but have not yet signaled any clear change in their respective stances.

It is likely that the U.S. bond market will revert to a positively sloped yield curve in 2024. While short-term yields will follow the Fed Funds Rate, longer-dated bonds may be slower to fall further given the lack of term premium and still relatively low

real yields. Nevertheless, long-term yields may move lower. The long-term floor for the 10-year is 3.25%; to reach that level would entail a receding economy accompanied by more rapidly improving inflation.

Strategy

We may have reached the end of the monetary tightening cycle. It is not a given as central banks remain laser-focused on inflation. However, it is likely that the yield curve will reflect economic reality by normalizing. Also, the Fed and other central banks will be loath to abandon their hard-fought gains against inflation prematurely. The lagged effect of monetary tightening is being felt now.

Last month we asked if it was the right time to extend duration. It is an important question. We believe the answer is yes for the Canadian bond market as the Canadian economy has stalled and the Bank of Canada's pause will continue despite its hawkish rhetoric. It may introduce a more dovish stance should the economy weaken further. Fixed income investors should consider moving further out the yield curve, to a maximum term of five years with a duration of two to three years.

We continue to advocate the use of floating-rate debentures for now. Those coupons should remain well above 5% even if central banks pause, in combination with a one- to five-year ladder of high-quality corporate and provincial bonds. The net result is a short-duration, high-yielding portfolio. We have recommended adding federal and provincial bonds to portfolios to enhance liquidity and credit quality in the event of some stress appearing in corporate credit.

This year's increase in yields has caused bonds issued at lower yields to trade at deep discounts to their par values. These bonds have proved to be attractive for taxable accounts, as the capital gains component of the overall return is taxed at preferential rates. While most of these bonds have rallied, considerable discounts remain. We have created the **Odlum Brown Discount Corporate Ladder** portfolio to take advantage of this opportunity and note there are a number of Government of Canada bonds available at deep discounts as well.

We also recommend using the **Odlum Brown Corporate Bond Ladder**, which features more current coupon bonds. The **Odlum Brown Model Portfolio** is well positioned for this environment with 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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