



## MONTHLY FIXED INCOME UPDATE

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September 15, 2021

Interest Rate Summary	Aug-31-21	Jul-30-21	Jun-30-21	May-31-21	Apr-30-21	Mar-31-21	Feb-27-21	Dec-31-20
<b>U.S.</b>								
3-Month T-Bill	0.04%	0.04%	0.04%	0.01%	0.01%	0.02%	0.04%	0.08%
2-Year Treasury	0.21%	0.19%	0.25%	0.14%	0.16%	0.16%	0.13%	0.12%
10-Year Treasury	1.31%	1.22%	1.46%	1.60%	1.63%	1.74%	1.41%	0.92%
<b>Canada</b>								
3-Month T-Bill	0.16%	0.17%	0.14%	0.11%	0.10%	0.08%	0.06%	0.06%
2-Year Canada	0.42%	0.45%	0.45%	0.32%	0.30%	0.22%	0.15%	0.20%
10-Year Canada	1.21%	1.20%	1.39%	1.48%	1.54%	1.56%	1.35%	0.68%

### Performance

	YTD	2020	2019	2018	2017	2016	2015
DEX Universe Bond Index	-2.59%	8.68%	6.87%	1.41%	2.52%	3.52%	3.52%
DEX Federal Bond Index	-2.18%	7.28%	3.73%	2.39%	0.13%	3.66%	3.66%
DEX Provincial Bond Index	-3.82%	9.86%	9.07%	0.66%	4.33%	4.14%	4.14%
DEX All Corporate Index	-1.35%	8.74%	8.05%	1.10%	3.38%	2.71%	2.71%
DEX "A" Corporate Index	-2.44%	8.98%	9.65%	0.51%	4.42%	2.62%	2.62%
DEX Real Return Bonds	-2.86%	13.02%	8.02%	-0.05%	0.72%	2.79%	2.79%
DEX High Yield Bonds	5.93%	6.69%	8.48%	2.15%	5.20%	13.79%	-5.58%

After experiencing rising yields in the first three months of the year, and with accompanying negative performance, the bond market again turned in mostly negative results in August. Government bonds showed mildly negative returns, while most corporate bond sectors outperformed the government sector, with small positive returns. High yield bonds produced the best returns for the month and year-to-date.

After falling in July, bond yields continued to move lower early in August with the U.S. ten-year note reaching 1.12%. Since then, the yield has trended higher, hitting 1.36% before settling at 1.31%, up nine basis points for the month. Since the end of August, this yield has risen a further six basis points.

The Federal Reserve signaled that it is going to begin tapering its bond purchases, perhaps as early as November. Other Central Banks, notably the ECB, the Bank of England and the Bank of Canada, have already begun to reduce bond purchases.

Inflation has been in the forefront of news, running at a hotter pace than estimated with little sign of softening. There is agreement among market participants that certain components of the Consumer Price Index will prove to be transitory but it is not certain that CPI will ease as much as the Fed believes. The chief obstacle may turn out to be the pace of wage increases, now running at a 6.6% annual rate, much higher than consensus.

The labour market remains tight, with over 10 million jobs available; upward pressure on labour costs is likely to persist.

As to Canada, a similar tightness exists in the labour market as hiring intentions are at record levels. A positive growth outlook will likely result in our inflation running hotter than expectations.

At today's ultra-low bond yields, corporate borrowers have been issuing record amounts of bonds. These issues have been heavily oversubscribed, narrowing yield spreads versus government bonds in the process.

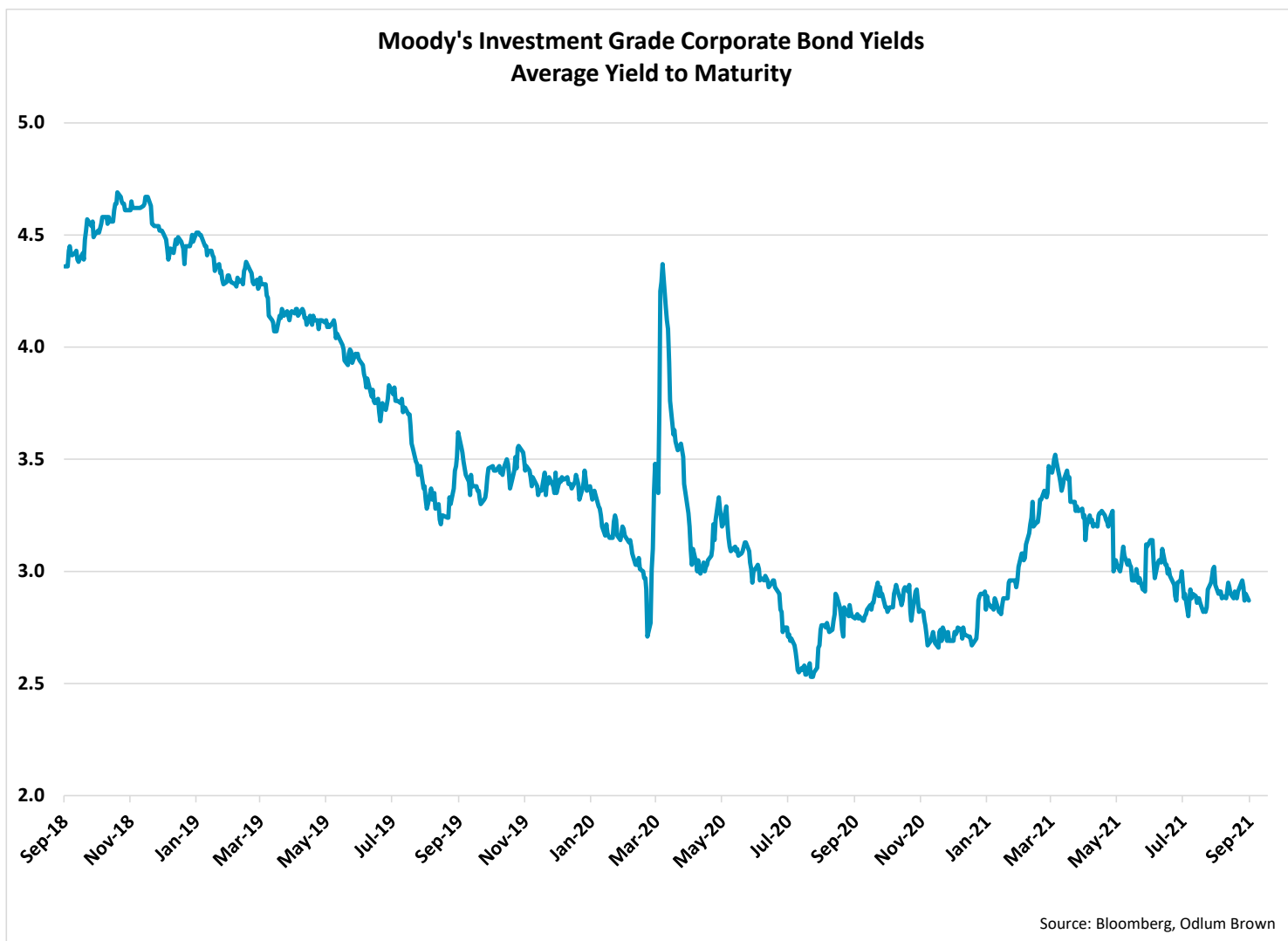
Overall, the recovery in North America and the world continues with inflation proving to be stubborn.

## U.S. 10-Year Treasury

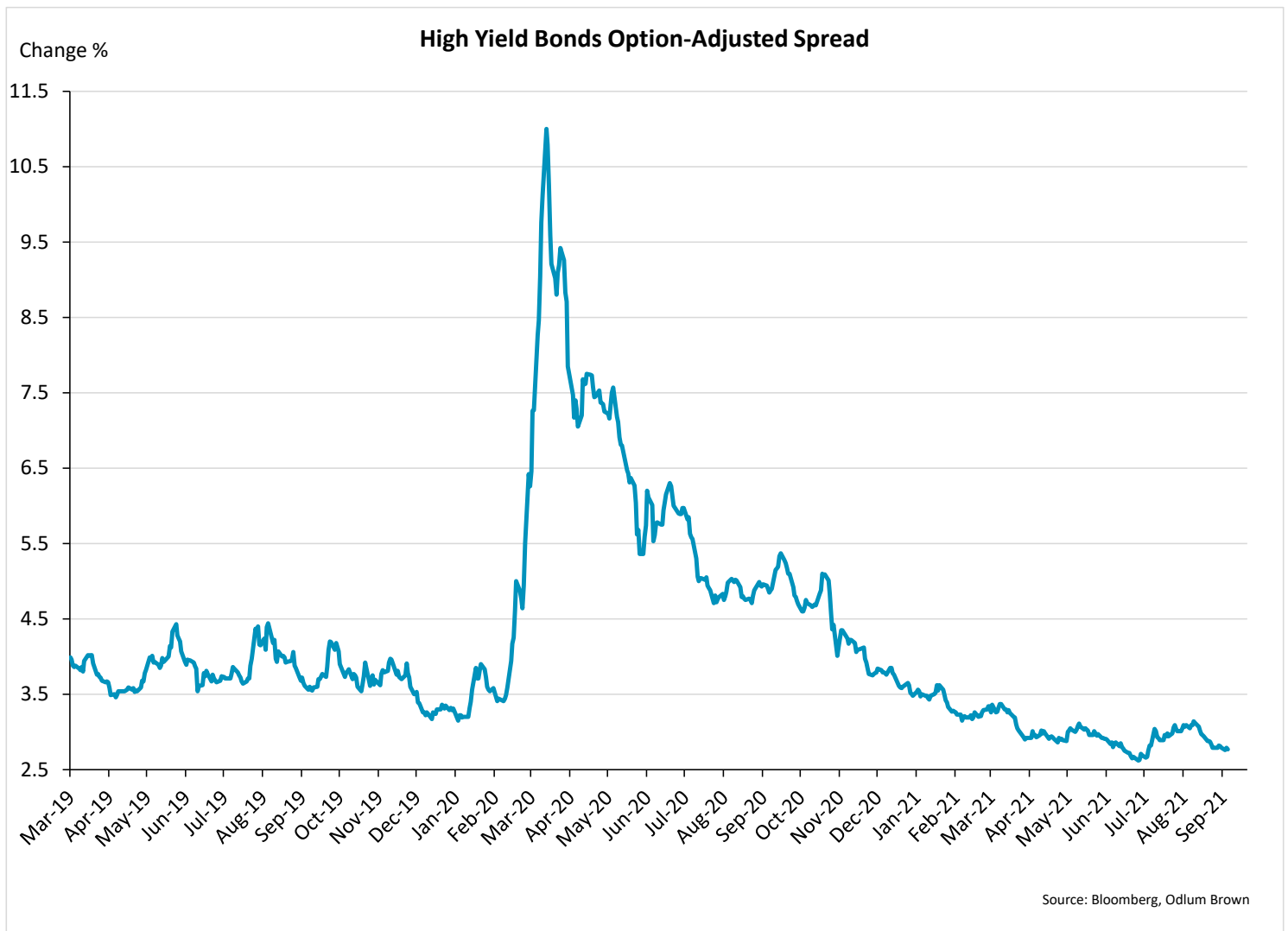
Yield (%)



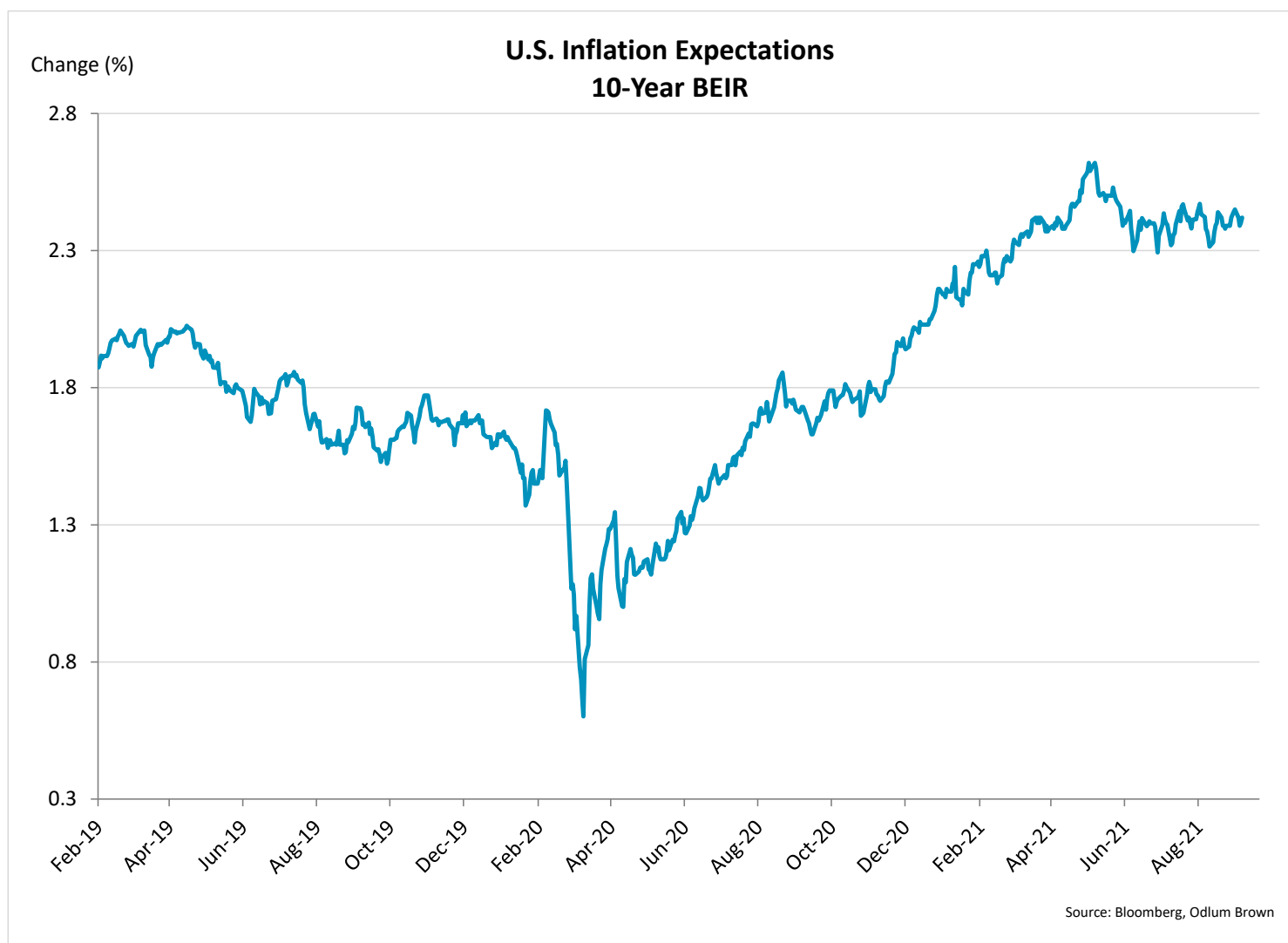
This benchmark's yield plunged in early August but has bounced up by twenty five basis points since that low. It is at a critical technical juncture, right at the main moving averages.



Investment-grade corporate bond yields began to move higher with U.S. Treasury yields early in the year and continue to track them closely despite record issuance.



**The high yield market remains close to record-low spreads, but there has been a modest widening of late.**



**After moving steadily lower, inflation expectations have stabilized.**

## Outlook

The outlook remains challenging for fixed income investors. Fixed income securities are the most expensive asset class as nominal yields remain substantially below the rate of inflation. Of late, there has been a discernible shift in the consensus that recent inflation prints will prove to be transitory as witness the noticeable leap in labour costs. Inflation is the enemy of bonds. The higher the rate of inflation, the faster the erosion of returns for fixed income securities.

The Fed is preparing the market for the beginning of the tapering of its massive monthly bond purchase program of \$120 billion. At the margin, these developments favour an upward bias to bond yields, which is more likely given the probability of even more fiscal stimulus.

It is possible that the bellwether U.S. ten-year note will reach 1.50% by year end. This modest uptick will ensure the continuation of moderate total returns for bonds.

## Strategy

This is a time to defend principal in the bond market as investing in long-term, long-duration 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, rather, invest in short-term, high-quality corporates, perhaps in the form of a bond ladder. This approach will defend principal while producing modest returns.

Specifically, we recommend a ladder 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.

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