MONTHLY FIXED INCOME UPDATE

Hank Cunningham **August 25, 2021**

Interest Rate Summary	Jul-30-21	Jun-30-21	May-31-21	Apr-30-21	Mar-31-21	Feb-27-21	Jan-29-21	Dec-31-20
U.S.								
3-Month T-Bill	0.04%	0.04%	0.01%	0.01%	0.02%	0.04%	0.05%	0.08%
2-Year Treasury	0.19%	0.25%	0.14%	0.16%	0.16%	0.13%	0.11%	0.12%
10-Year Treasury	1.22%	1.46%	1.60%	1.63%	1.74%	1.41%	1.07%	0.92%
Canada								
3-Month T-Bill	0.17%	0.14%	0.11%	0.10%	0.08%	0.06%	0.06%	0.06%
2-Year Canada	0.45%	0.45%	0.32%	0.30%	0.22%	0.15%	0.15%	0.20%
10-Year Canada	1.20%	1.39%	1.48%	1.54%	1.56%	1.35%	0.89%	0.68%

Performance

	YTD	2020	2019	2018	2017	2016	2015
DEX Universe Bond Index	-2.47%	8.68%	6.87%	1.41%	2.52%	3.52%	3.52%
DEX Federal Bond Index	-2.11%	7.28%	3.73%	2.39%	0.13%	3.66%	3.66%
DEX Provincial Bond Index	-3.57%	9.86%	9.07%	0.66%	4.33%	4.14%	4.14%
DEX All Corporate Index	-1.36%	8.74%	8.05%	1.10%	3.38%	2.71%	2.71%
DEX “A” Corporate Index	-2.40%	8.98%	9.65%	0.51%	4.42%	2.62%	2.62%
DEX Real Return Bonds	-2.49%	13.02%	8.02%	-0.05%	0.72%	2.79%	2.79%
DEX High Yield Bonds	5.54%	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 turned in mostly positive results in July. Government bonds showed mildly positive returns, with most corporate bond sectors outperforming the government sector. Real Return bonds bounced back as well. Note that year-to-date performance is negative for all sectors except high yield.

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, this yield has trended higher, hitting 1.36% before settling at 1.22%, up ten basis points for the month-to-date. All eyes remain focused on the Federal Reserve (Fed) and the likelihood that it will begin to taper its $120 billion per month purchases. Leaks from senior Fed officials suggest that tapering could begin by the end of 2021.

The standout events in August have been employment and inflation. On the employment front, the U.S. added 943,000 jobs, with a sizeable upward revision to the previous month. The U.S. unemployment rate fell to 5.9%. Such strength is likely to persist as there are one million jobs available; also, initial jobless claims have fallen steadily. Likewise, Canada's employment report was encouraging, with 94,000 new jobs and an unemployment rate of 7.5%.

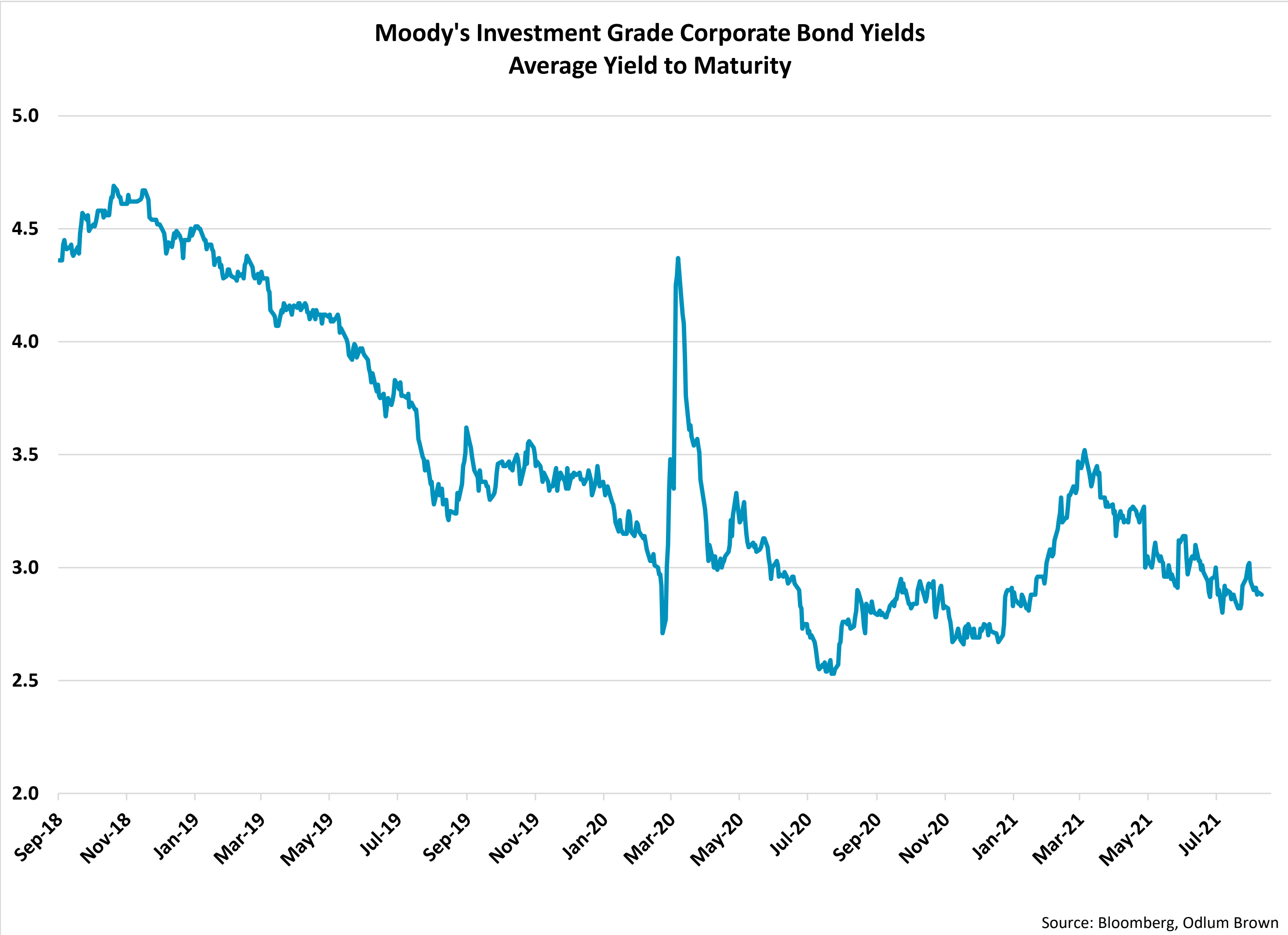
U.S. retail sales have cooled but manufacturing has picked up. The housing market is still vibrant with its chief weakness being a shortage of inventory.

As to inflation, U.S. core CPI rose at 4.3%, for the fourth-straight month above expectations. Similarly, Canada's year-over-year CPI hit 3.7%, the largest increase since 2008.

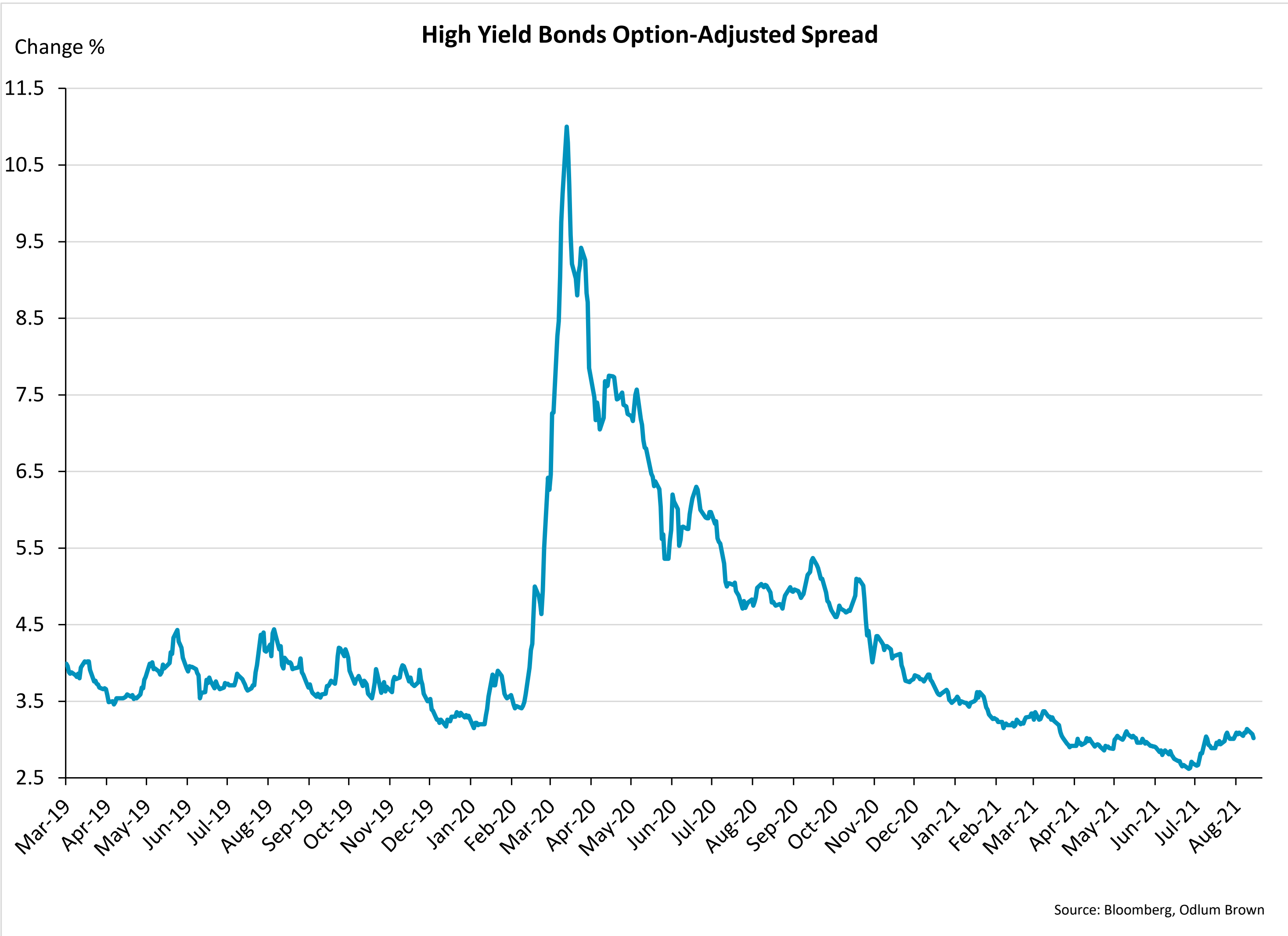
Overall, the recovery in North America and the world continues with inflation proving to be stubborn.

U.S. 10-Year Treasury

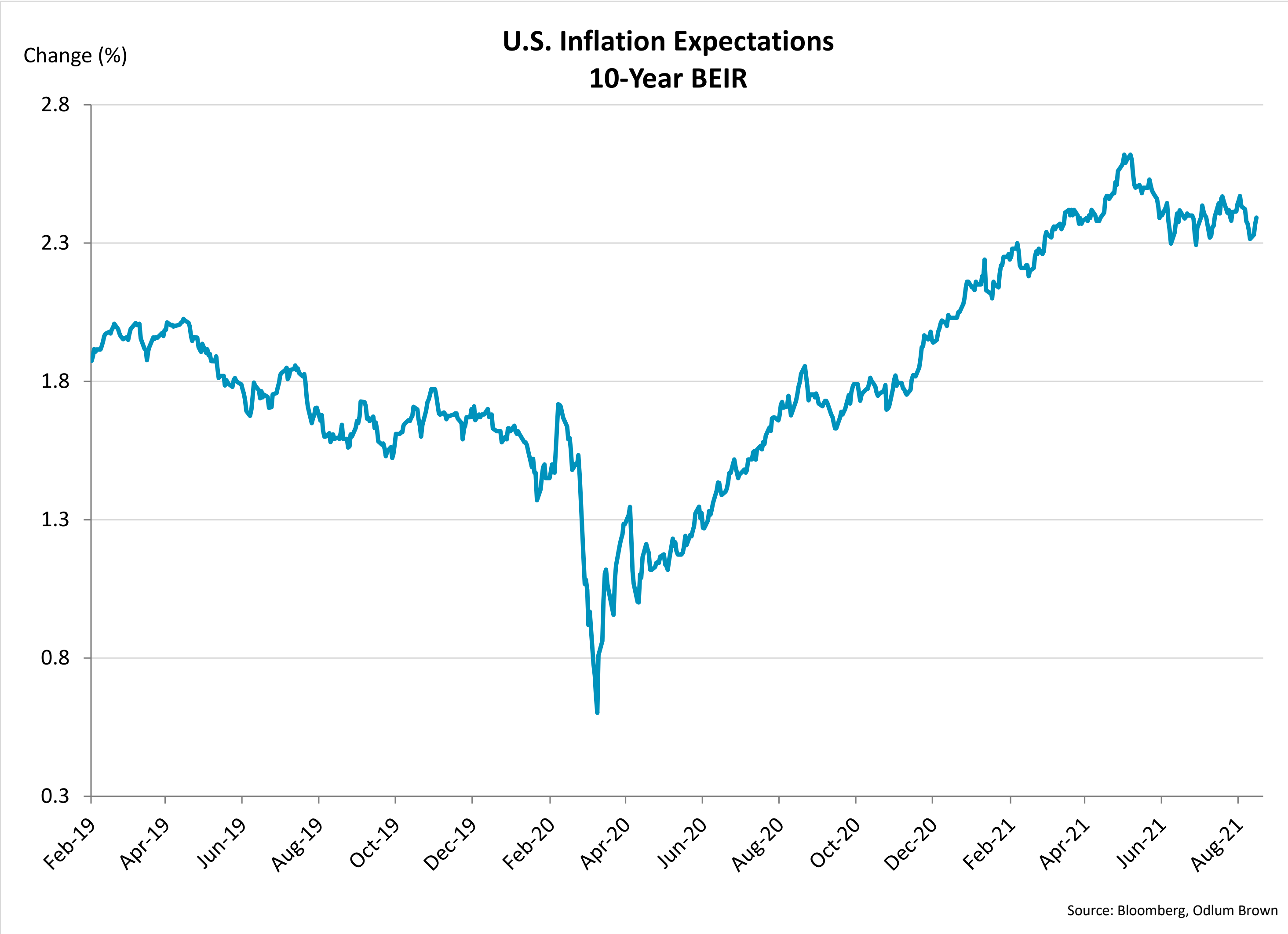
This benchmark issue plunged in yield in early August and has bounced up by twenty basis points since. It is at a critical technical juncture.



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



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 ticked up again.

Outlook

The outlook remains challenging for fixed income investors. While bond yields have risen twenty basis points from their early August lows, they remain well 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. Inflation is proving to be stickier than previously thought. Also, 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.

Overall, the lower-for-longer environment for yields will persist. Fixed income investors will thus face a period of modest returns**.**

Strategy

The normal approach in such an environment, where real yields are negative 3%, is to reach for yield. That implies investing in long-term, low-quality corporate bonds. We do not counsel such an approach as long-term, low-quality bonds offer the attendant risks of price and capital loss. Instead, we recommend high-quality corporate bonds of relatively short duration. This approach will produce low single-digit returns and protect principal.

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 for more details and to discuss this strategy.