Monthly Fixed Income Update

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Interest Rate Summary	31-Jan-17	30-Dec-16	31-Dec-15	31-Dec-14	31-Dec-13	31-Dec-12
U.S.						
3-Month T-Bill	0.52%	0.50%	0.16%	0.04%	0.07%	0.04%
2-Year Treasury	1.21%	1.19%	1.31%	0.47%	0.38%	0.25%
10-Year Treasury	2.45%	2.44%	2.27%	2.17%	3.03%	1.76%
Canada						
3-Month T-Bill	0.45%	0.45%	0.51%	0.90%	0.92%	0.92%
2-Year Canada	0.77%	0.74%	0.48%	0.99%	1.14%	1.14%
10-Year Canada	1.76%	1.72%	1.39%	1.86%	2.76%	1.80%

Performance

	Jan-2017	Year-to-Date	2016	2015	2014	2013	2012
DEX Universe Bond Index	-0.12%	1.66%	3.52%	3.52%	8.79%	-1.19%	2.65%
DEX Federal Bond Index	-0.14%	0.00%	3.66%	3.66%	6.91%	-1.52%	2.111%
DEX Provincial Bond Index	-0.52%	1.76%	4.14%	4.14%	12.18%	-2.70%	
DEX All Corporate Index	0.41%	3.73%	2.71%	2.71%	7.58%	0.84%	6.22%
DEX "A" Corporate Index	0.22%	3.60%	2.62%	2.62%	9.10%	-0.16%	6.85%
DEX Real Return Bonds	-1.78%	2.86%	2.79%	2.79%	13.18%	-13.1%	
DEX High Yield Bonds	2.13%	16.93%					

Comments:

Performance was mixed in January. Government bonds and Real Return Bonds produced negative returns while both investment-grade and high-yield corporate bonds produced positive results.

The U.S. ten-year note tacked on a mere one basis point for the month but this masked the results somewhat. During the month, the ten-year note pushed above 2.50% before its yield began to slide into month-end. This marked the first interruption in the Trump reflation rally. Employment reports remained solid in the U.S. but the disappointingly weak increase in hourly wage brought demand back into the bond market. As well, there was a huge corporate borrowing calendar which was readily absorbed.

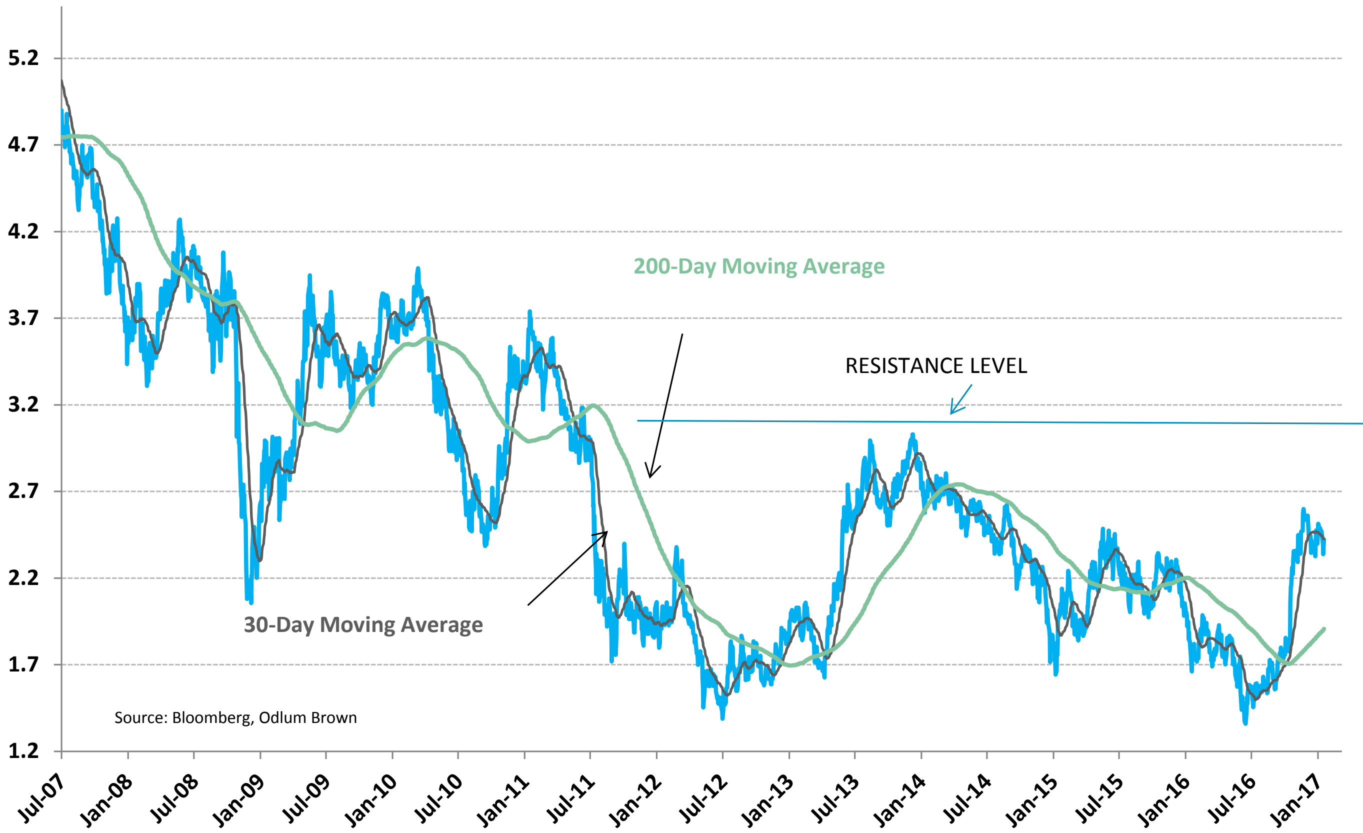
In Canada, solid jobs and trade reports have buoyed our currency. This is despite the Bank of Canada jawboning it lower. Governor Poloz went so far as to say that a rate cut was still on the table.

Inflation remains contained and comfortably below Central Bank thresholds. Meanwhile, consumer confidence is riding high, auto sales are strong, and the housing market is vibrant. Conditions are also improving in China, Japan and Europe.

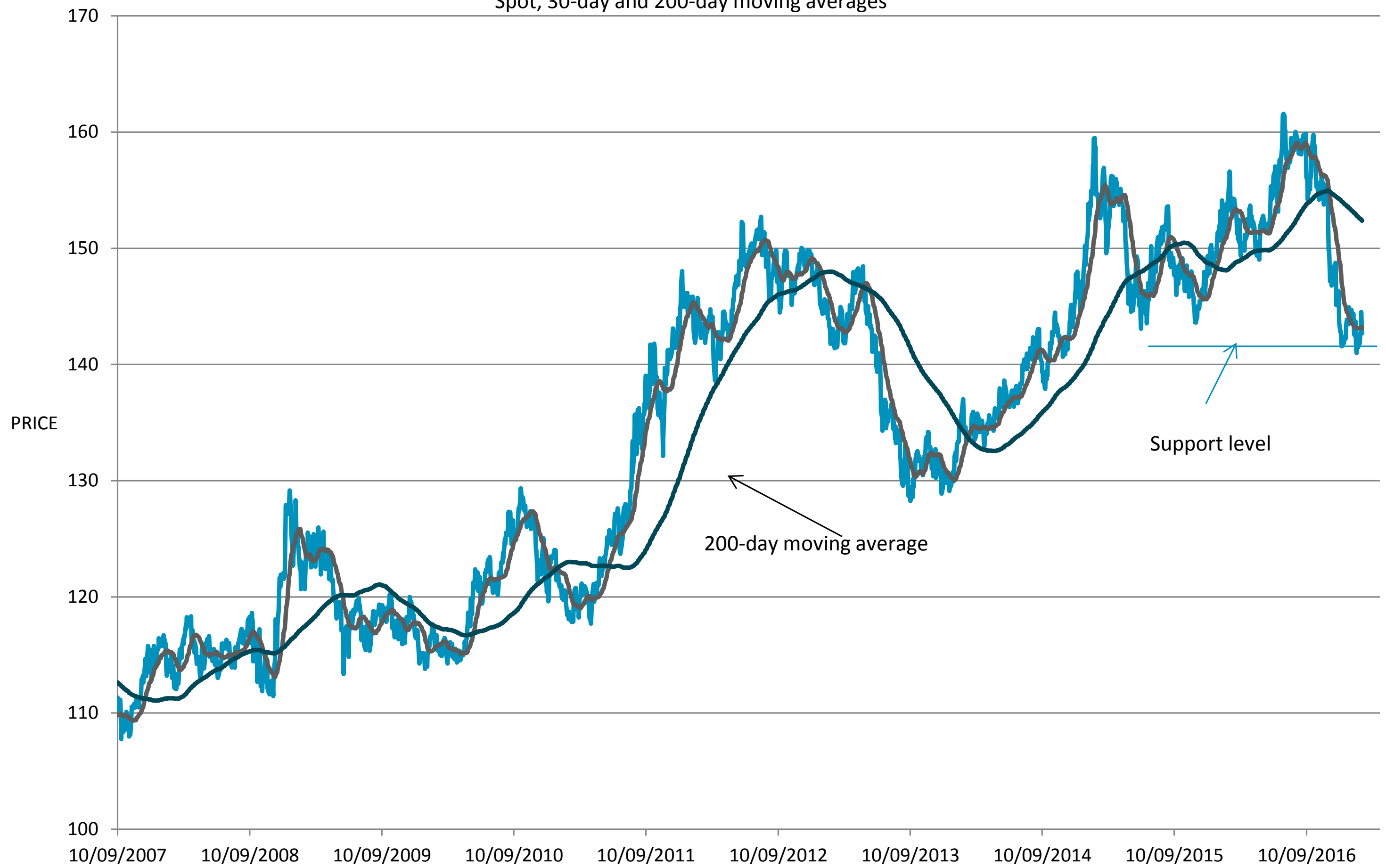
The gathering momentum is feeding through to commodity prices in general, presaging a pickup in inflation.

U.S. 10-Year Treasury

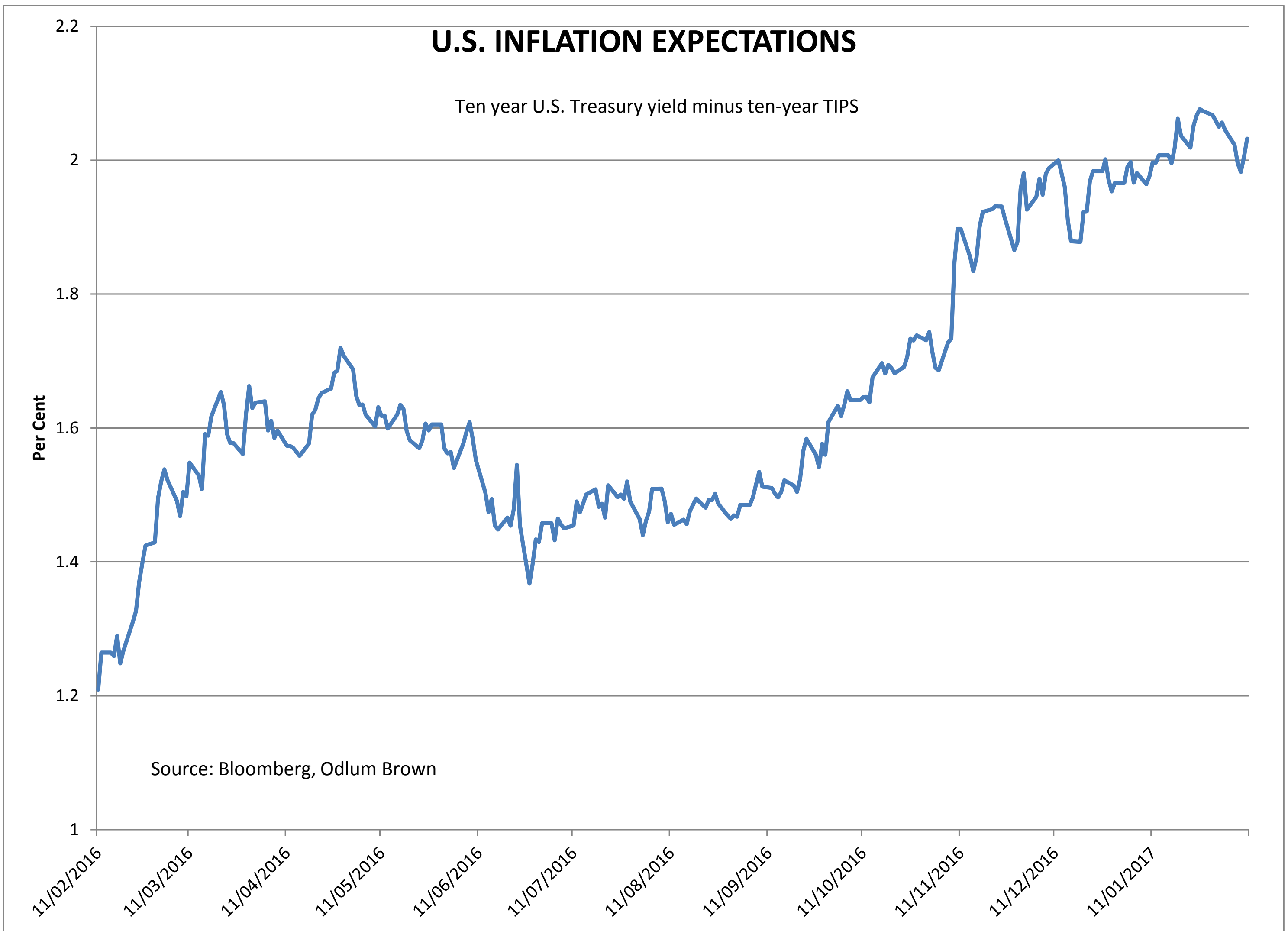
Yield (%)



This chart displays the trend of the U.S. ten-year bond yield. It is too early to forecast that a new long-term trend has begun as there is considerable resistance at 3%.



The price of this long-term Canada bond has plummeted and then bounced off a key support level.



This chart demonstrates that inflation expectations are rising. The break-even inflation rate has been rising steadily over the past several months and has spiked since the election.

Outlook

Have we seen the end of the secular decline in bond yields? The answer to this question will take months and perhaps years to reveal itself. In the short-term, economic conditions are improving globally.

The U.S. economy is improving in all sectors and, with the potential for fiscal stimulus, it could grow by 2.5% this year. The Fed will continue to normalize yields with the next hike in the Fed Funds Rate likely to happen in March.

Overall, we believe that the upward trend in bond yields will continue. Our target is for the U.S. ten-year yield to reach 3% during 2017. This is based on firming commodity prices, the inevitable increase in wages, firming growth in the rest of the world, and positive consumer sentiment.

Canada's economy continues to surprise to the upside; employment reports have been surprisingly strong and we have recorded two consecutive trade surpluses.

Strategy

We see little reason to alter our advice to remain fully invested in short duration corporate bonds diversified by credit and maturity. Those investors who have maintained their laddered approach have enjoyed positive returns at all maturities. As always, in the investment-grade portion of a fixed-income portfolio, we are ever mindful of credit risk and remain advocates of those credits non-cyclical in nature. Our emphasis remains on safety of principal.

Although we recommend up to 10% of a fixed-income portfolio be invested in high-yield credits, either by way of ETFs or via careful selection of individual bonds, we now counsel caution. High-yield bonds are near their lows in yield for the past twelve months and may have achieved most of their potential return. Should investment-grade bond yields continue to trend higher, there will be pressure on high-yield bonds although we expect that they will produce positive total returns.

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