## Monthly Fixed Income Update

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| Interest Rate Summary | 31-Jan-18 | 29-Dec-17 | 30-Dec-16 | 31-Dec-15 | 31-Dec-14 | 31-Dec-13 | 31-Dec-12 |
|---|---|---|---|---|---|---|---|
| **U.S.** | | | | | | | |
| 3-Month T-Bill | 1.46% | 1.38% | 0.50% | 0.16% | 0.04% | 0.07% | 0.04% |
| 2-Year Treasury | 2.14% | 1.89% | 1.19% | 1.31% | 0.47% | 0.38% | 0.25% |
| 10-Year Treasury | 2.71% | 2.41% | 2.44% | 2.27% | 2.17% | 3.03% | 1.76% |
| **Canada** | | | | | | | |
| 3-Month T-Bill | 1.19% | 1.05% | 0.45% | 0.51% | 0.90% | 0.92% | 0.92% |
| 2-Year Canada | 1.84% | 1.69% | 0.74% | 0.48% | 0.99% | 1.14% | 1.14% |
| 10-Year Canada | 2.29% | 2.04% | 1.72% | 1.39% | 1.86% | 2.76% | 1.80% |

**Performance**

| | Jan-2018 | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|---|---|
| DEX Universe Bond Index | -0.80% | 2.52% | 3.52% | 3.52% | 8.79% | -1.19% | 2.65% |
| DEX Federal Bond Index | -0.77% | 0.13% | 3.66% | 3.66% | 6.91% | -1.52% | 2.11% |
| DEX Provincial Bond Index | -1.26% | 4.33% | 4.14% | 4.14% | 12.18% | -2.70% | |
| DEX All Corporate Index | -0.24% | 3.38% | 2.71% | 2.71% | 7.58% | 0.84% | 6.22% |
| DEX "A" Corporate Index | -0.34% | 4. 42% | 2.62% | 2.62% | 9.10% | -0.16% | 6.85% |
| DEX Real Return Bonds | -0.42% | 0.72% | 2.79% | 2.79% | 13.18% | -13.1% | |
| DEX High Yield Bonds | 1.01% | 9.94% | | | | | |

**Comments:**

Performance was negative in all sectors of the bond market in January, except for high yield bonds.

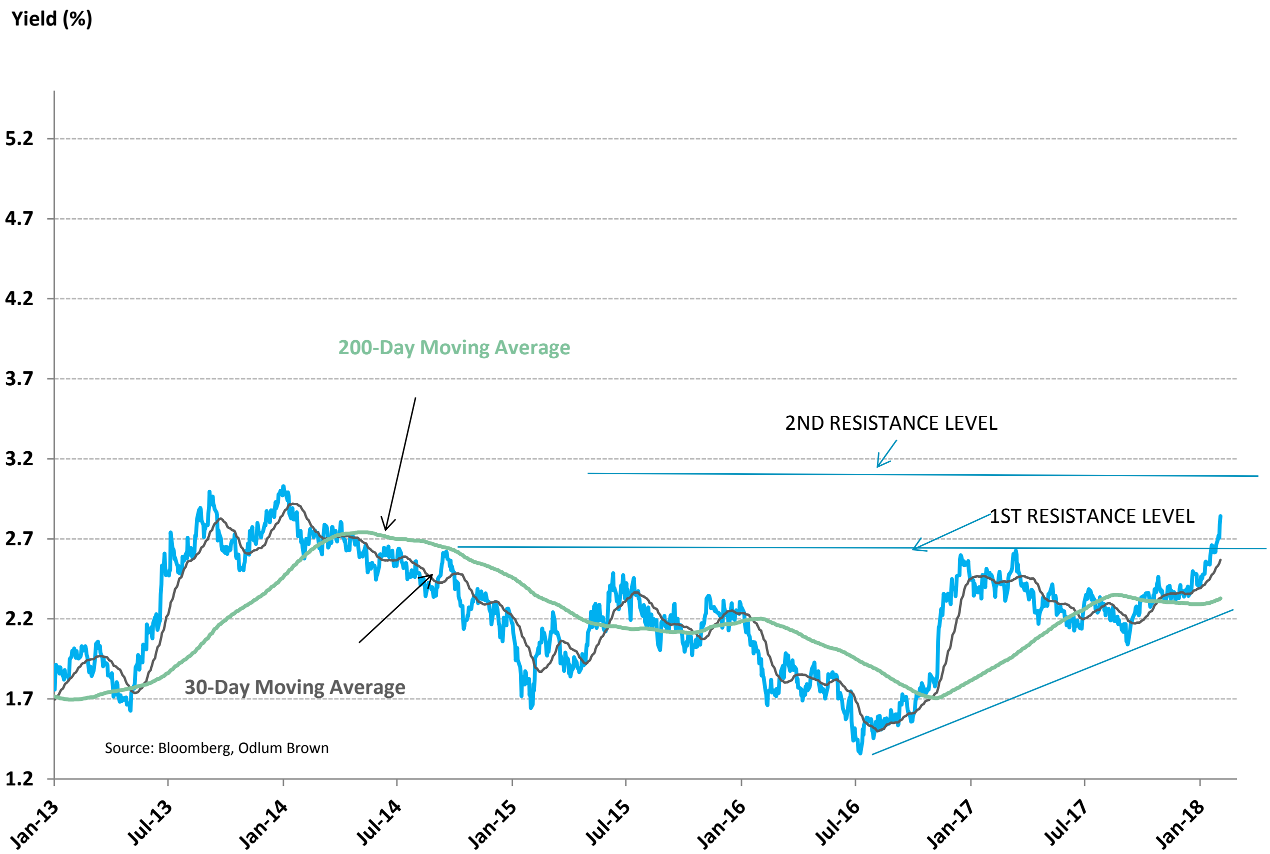
U.S. two- and ten-year yields rose by more than their respective Canadian maturities. January ushered in a bear market in bonds. The bellwether ten-year U.S. note rose by thirty basis points and has tacked on another fifteen basis points after the month-end. Yield curves in the U.S. and Canada steepened for the month, albeit by a modest five basis points.

The following factors identify the sources of rising bond yields:

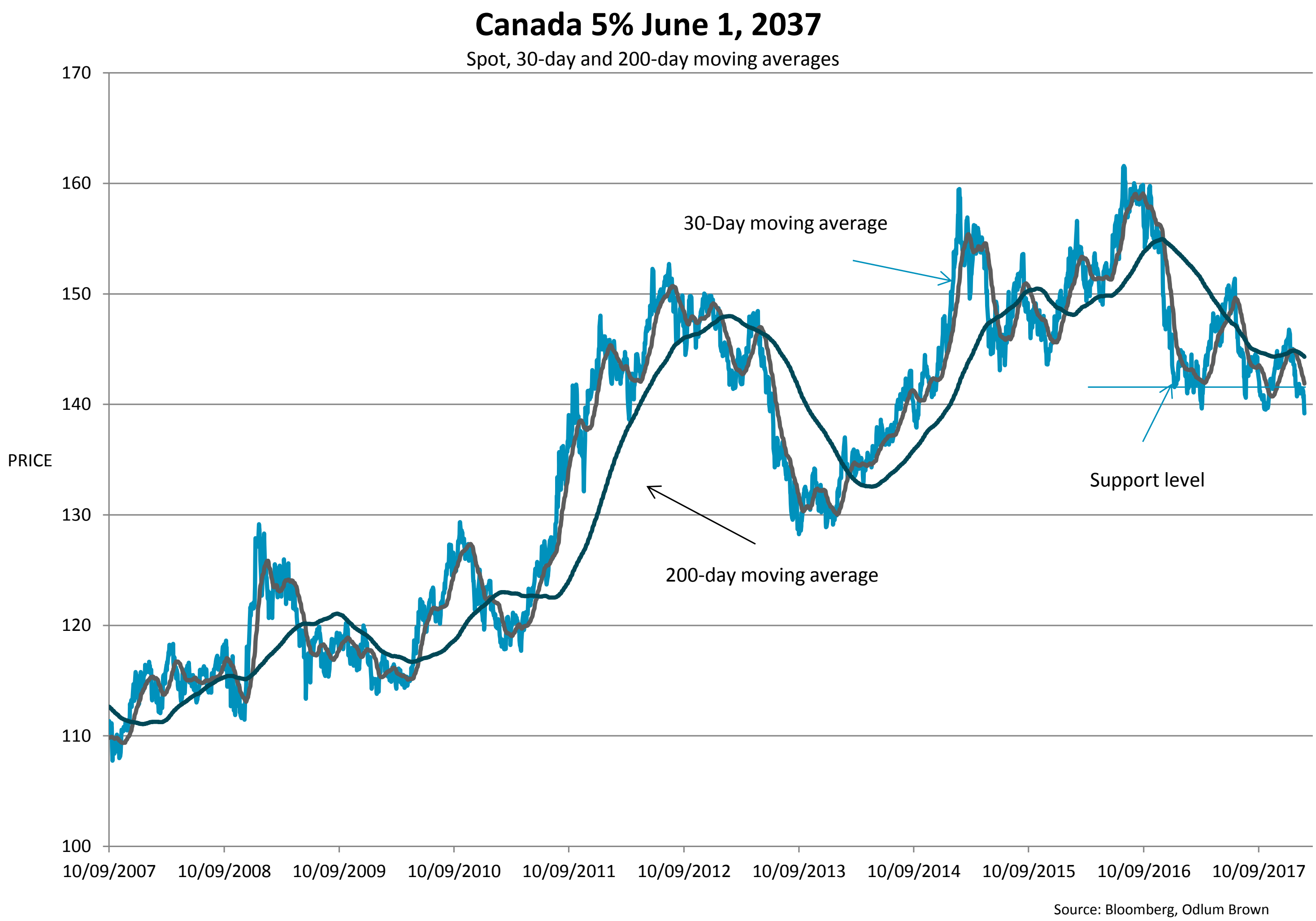
- Growing global economic growth – world growth reached 4% in Q3
- Solid economic performance in almost all U.S. sectors: housing, construction, manufacturing, exports, consumer spending and optimism, and vehicle sales
- Modest uptick in inflation, which has reached 2% year-over-year
- Buoyant labour market – wages advanced in the U.S. by 2.9% year-over-year, the most rapid since 2009
- Increased supply – the combination of the increased deficit plus the run-off from the Federal Reserve's balance sheet means that there will be an extra $500 billion in new U.S. Treasury supply.

In Canada, there was another blowout jobs report, pushing the unemployment rate to 5.7%, the lowest it's been since 1974! The Bank of Canada responded with an increase in its overnight lending rate. It was considered "dovish" as Bank of Canada Governor Poloz has one eye fixed squarely on the NAFTA negotiations. At the same time, the Loonie climbed compared to the generally weak U.S. dollar; this strength has had the effect of monetary tightening.

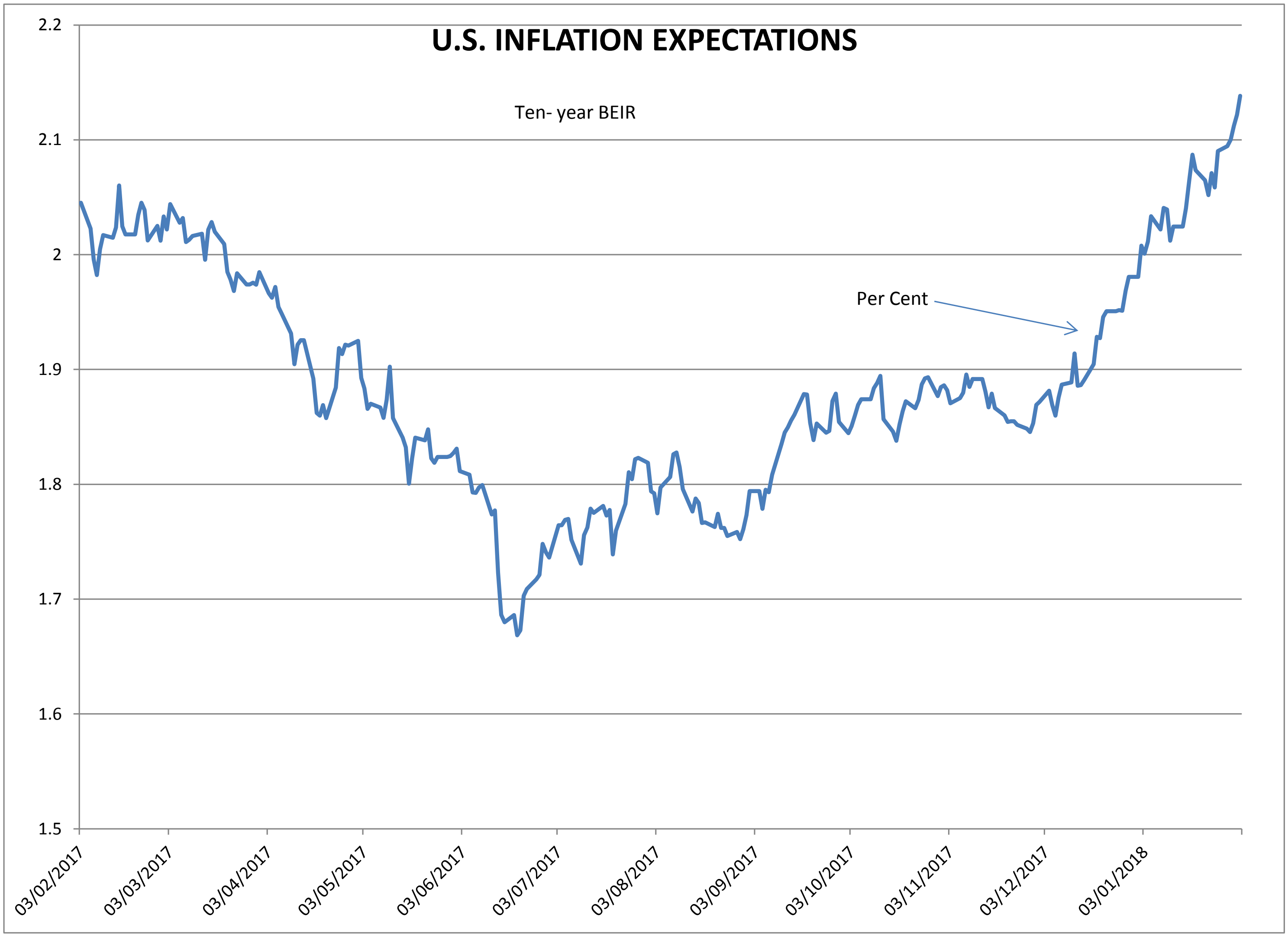
**U.S. 10-Year Treasury**




**The yield on this bellwether bond shot through its first resistance level at 2.63% and is rapidly advancing major resistance at 3%.**

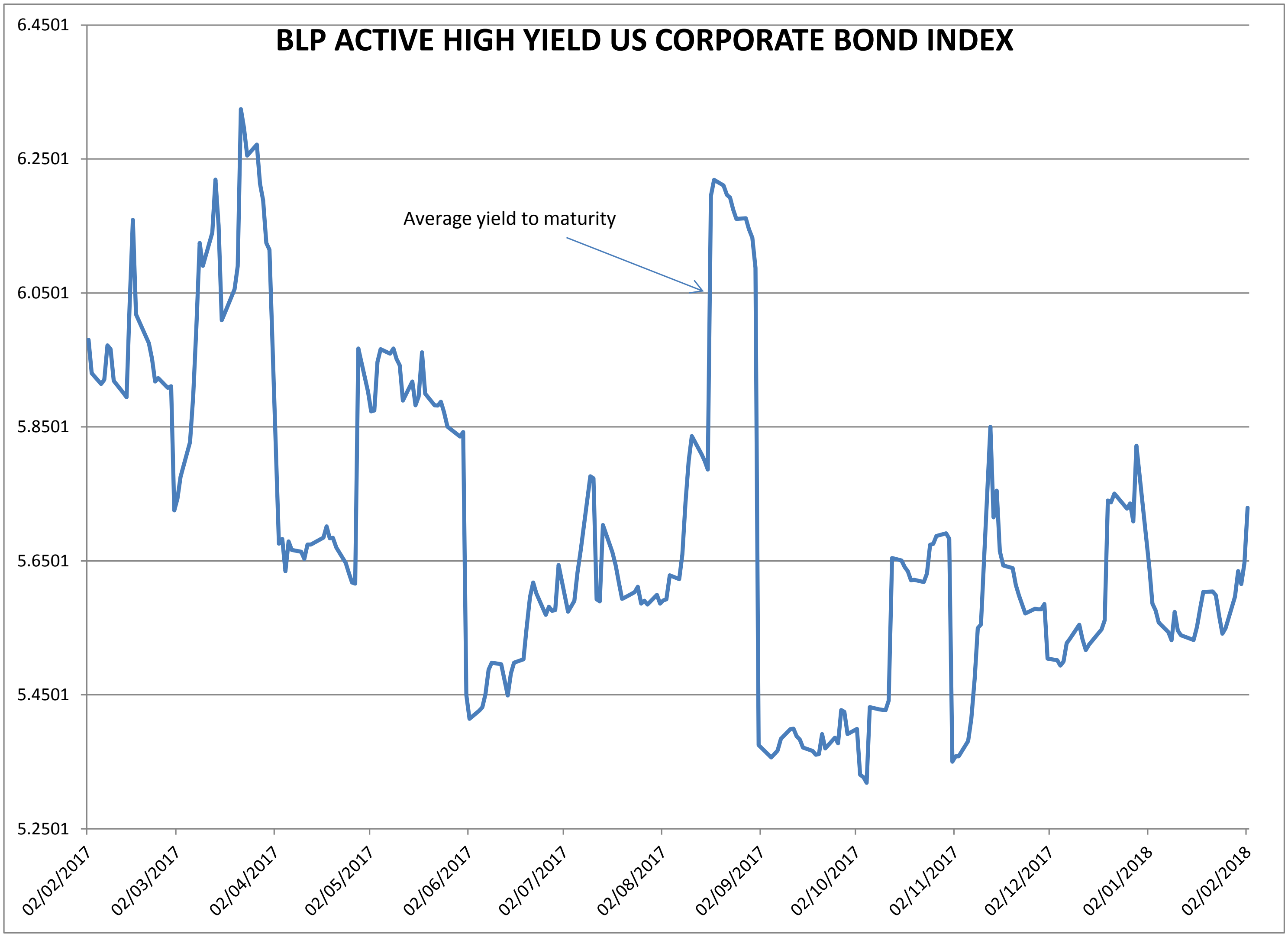



**The price of this long-term Canada bond dropped sharply and has broken through a major support line.**




Source: Bloomberg, Odlum Brown

**Inflation expectations have moved solidly above 2%.**




Source: Bloomberg, Odlum Brown

**The high yield market has finally succumbed to rising U.S. Treasury yields.**

**Outlook**

The trend towards higher bond yields globally should remain in place. It is likely that Central Banks everywhere will continue to withdraw stimulus. In North America, certainly, the Federal Reserve will raise rates on two or three occasions. The Bank of Canada may follow but at a slower pace. Thus far, the European Central Bank and the Bank of Japan have not signalled any further action but they should be watched closely.

The U.S. Treasury, in response to the growing federal deficit, has already made sizeable additions to all upcoming auctions of Treasury notes and bonds. This is coming at a time when $30 billion a month of maturing bonds and mortgage securities are coming off the Fed's balance sheet.

The most recent U.S. employment report may have provided the tipping point for bond yields as wage growth expanded by the most since 2009 as labour market conditions have tightened further.

Thus, we believe that the recent upward yield trend will continue at all maturities. Past run-ups in market yields have often given way to subsequent sharp rallies in bond prices. U.S. bond yields stand out in the world as being relatively high. Yields are on the rise globally as witnessed by the increase in German ten-year bund yields to 0.76%, double what they were a few months past. Thus, while there may be short-term rallies after such a dramatic selloff in bond prices, we believe that the die has been cast for the bond market.

**Strategy**

Against this backdrop, it is difficult to foresee anything but modest to negative returns in fixed income portfolios. At the core of bond portfolios, we counsel fixed income investors to have high-quality, short-duration corporate bonds. This core could be augmented by a representation in the high yield market. Even with the expected rise in government yields, total returns in the high yield market should still exceed returns from the government sector. There is a case to be made for selected investment in funds of certain investment management firms. We endorse a number of those that have added value to clients' portfolios. For more information, please speak to your advisor.