Monthly Fixed Income Update

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Interest Rate Summary	Jan-31-20	Dec-31-19	Nov-29-19	Dec-31-18	29-Dec-17	30-Dec-16	31-Dec-15
U.S.							
3-Month T-Bill	1.55%	1.55%	1.58%	2.36%	1.38%	0.50%	0.16%
2-Year Treasury	1.32%	1.57%	1.53%	2.49%	1.89%	1.19%	1.31%
10-Year Treasury	1.51%	1.92%	1.78%	2.69%	2.41%	2.44%	2.27%
Canada							
3-Month T-Bill	1.64%	1.65%	1.65%	1.64%	1.05%	0.45%	0.51%
2-Year Canada	1.43%	1.69%	1.58%	1.86%	1.69%	0.74%	0.48%
10-Year Canada	1.27%	1.70%	1.46%	1.97%	2.04%	1.72%	1.39%

Performance

	YTD	2019	2018	2017	2016	2015	2014
DEX Universe Bond Index	2.91%	6.87%	1.41%	2.52%	3.52%	3.52%	8.79%
DEX Federal Bond Index	2.37%	3.73%	2.39%	0.13%	3.66%	3.66%	6.91%
DEX Provincial Bond Index	3.60%	9.07%	0.66%	4.33%	4.14%	4.14%	12.18%
DEX All Corporate Index	2.68%	8.05%	1.10%	3.38%	2.71%	2.71%	7.58%
DEX "A" Corporate Index	3.14%	9.65%	0.51%	4.42%	2.62%	2.62%	9.10%
DEX Real Return Bonds	4.12%	8.02%	-0.05%	0.72%	2.79%	2.79%	13.18%
DEX High Yield Bonds	1.27%	8.48%	2.15%	5.20%	13.79%	-5.58%	2.64%

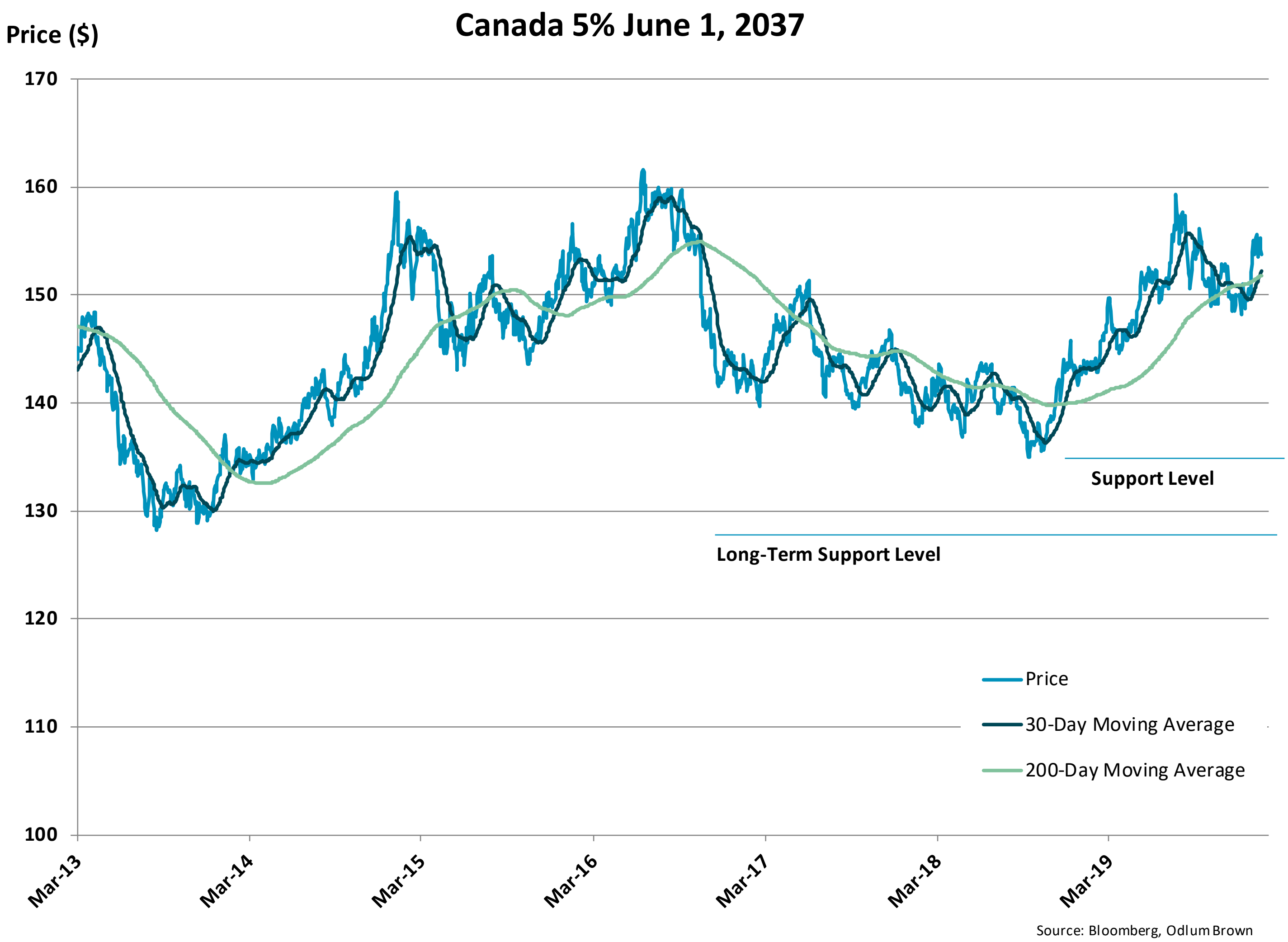
All sectors produced positive returns in January with long-term Government bonds producing the best returns. The high yield sector lagged for the third consecutive month.

Comments:

After three months of steadily rising bond yields and a steepening yield curve, the bond market turned on a dime in January. The ten-year bellwether yield plummeted 41 basis points and the yield curve flattened by 16 basis points. The catalyst for this abrupt reversal can be traced to fears surrounding the coronavirus. Not only did it spark a massive flight-to-quality but it also brought attention to the fragile state of the global economy, particularly that of the Chinese economy. Nevertheless, economic data has remained constructive and thus bond yields have retraced 15 basis points of their decline. High-yield bonds suffered as a result of enhanced economic fears, particularly in relation to the oil industry where defaults are rising. Investment-grade bonds remain very tight in yield to government bonds.

The latest strong U.S. and Canadian employment reports underscore the resilience of North American economies despite the threat to growth from the virus outbreak. Both the Federal Reserve and the Bank of Canada have moved squarely to the sidelines with a wary eye on potential threats to growth.

Conditions in Europe signal that the worst may be over. Even Japan’s economic outlook has brightened somewhat.

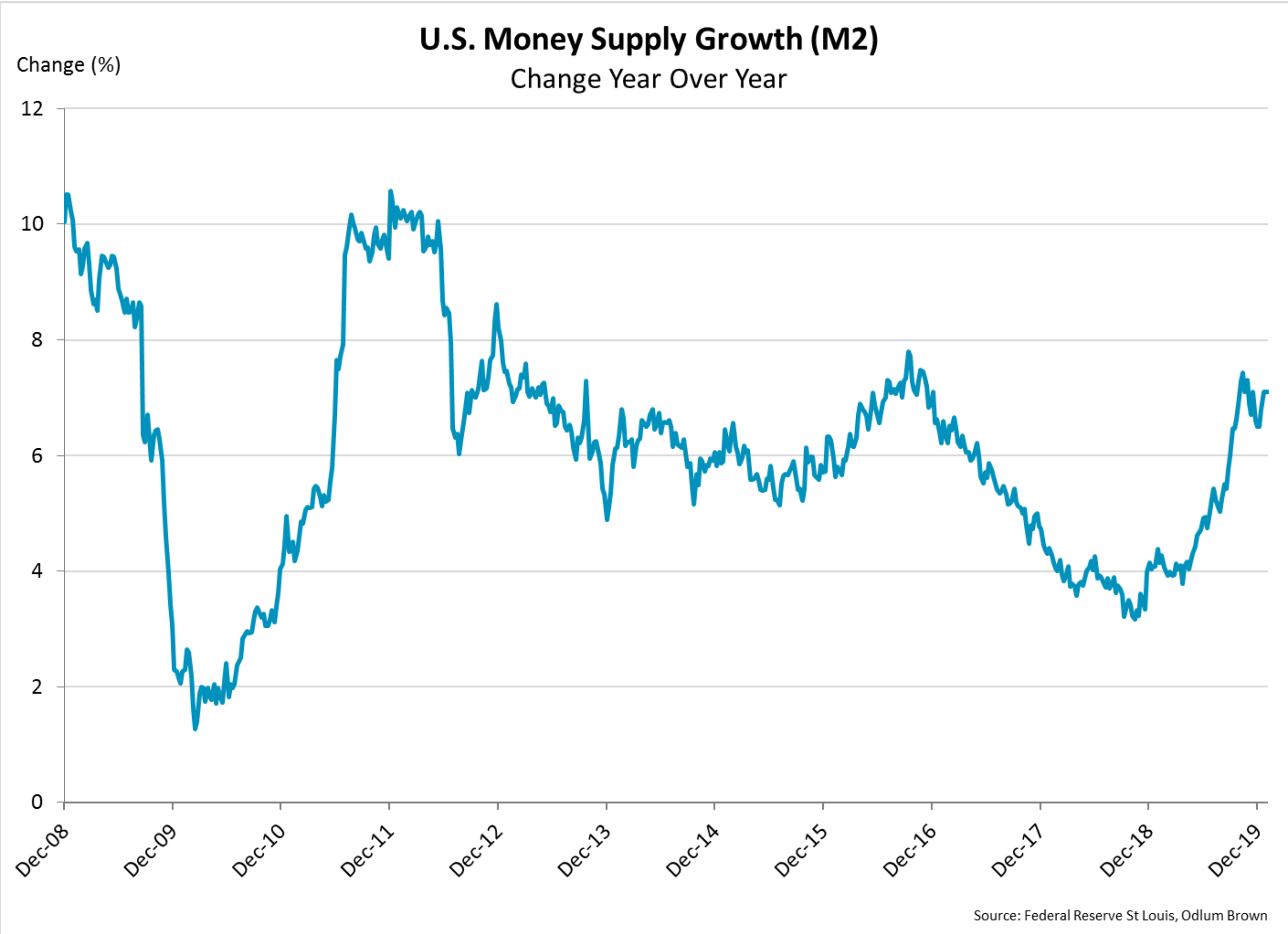


This bond climbed sharply and is well above its key moving averages.

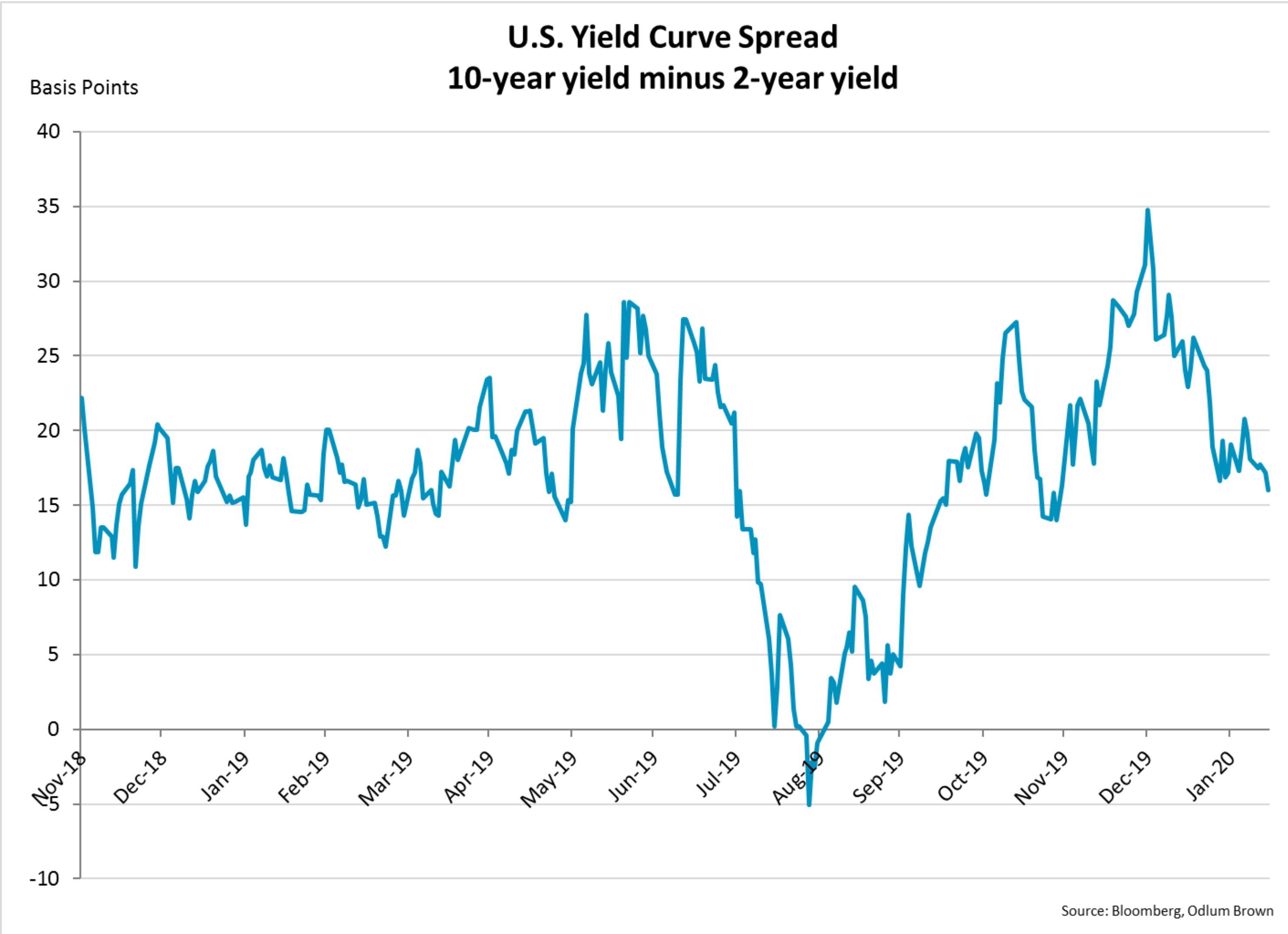
U.S. 10-Year Treasury

Source: Bloomberg, Odlum Brown

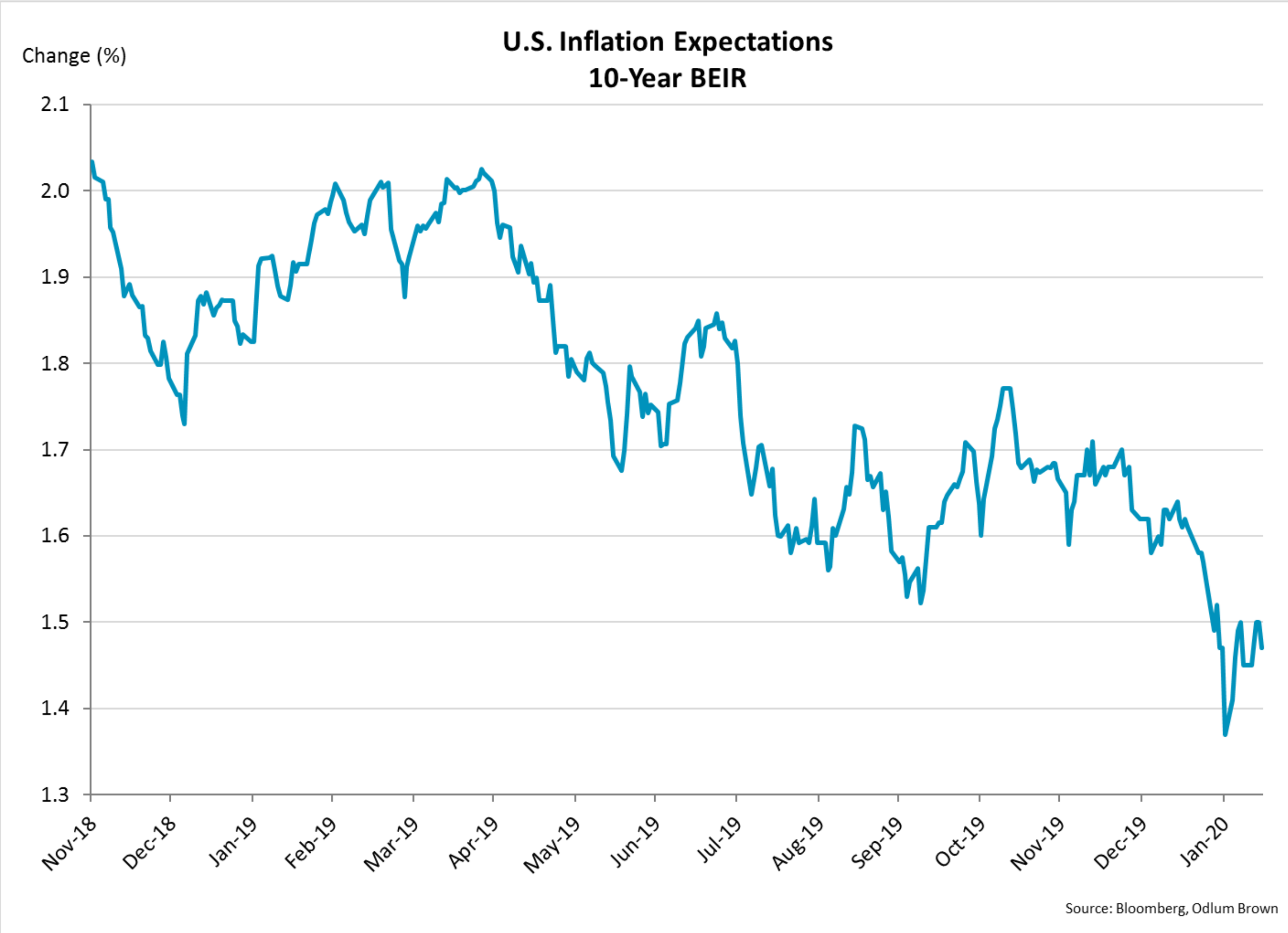
This global bellwether bond's yield moved sharply lower and has stabilized at these lower yields.



This broad measure of money supply continues to grow at a positive pace, brightening the outlook for growth.



The yield curve has flattened but remains positive.



Inflation expectations have moved lower.

Outlook

The trend towards higher bond yields, evident in the fourth quarter of 2019, has been interrupted by the outbreak of the coronavirus and the attendant risks to global growth. Thus far, economic data, particularly in North America, remains encouraging, but has not yet been accompanied by any meaningful pickup in inflation. There are some signs from Europe and Japan that the worst may be over for their economies. Nevertheless, the amount of negative-yielding bonds has increased by $2 trillion after this latest yield plunge. This, in turn, makes North American bonds look attractive, effectively capping bond yields. The ten-year U.S. bellwether made a double-top at 1.95%. That level may prove to be the ceiling for bond yields for the foreseeable future.

Although, at the margin, the virus outbreak might increase the odds of a rate cut by the Federal Reserve and the Bank of Canada, economic data argues for no imminent change in monetary policy.

Yields on investment-grade corporate bonds have moved to rarely-seen tight spreads versus government bond yields and thus have limited upside. The U.S. yield curve has flattened but remains positive. The U.S. ten-year note is in a trading range of 1.45% to 1.95%. To break above 1.95% would take synchronized global growth accompanied by firmer inflation. That does not appear likely to happen. Although Central Banks are monitoring carefully the economic fallout from the coronavirus, they will probably remain on the sidelines. China is throwing massive fiscal stimulus at its economy and other countries may fallow suit. This argues for some increase in bond yields and a steeper yield curve.

Strategy

It is unlikely that fixed income investors will reap returns in 2020 similar to what they enjoyed in 2019. We continue to counsel a high-quality, short duration approach to bond investments as protection of principal is paramount. We have long advocated the laddered approach when constructing a fixed income portfolio. We are not recommending high-yield bonds as their relatively tight yield spread to U.S. Treasury yields limits their upside.

There is no reason to alter this strategy as it removes the guesswork from fixed income investing. Therefore, a ladder composed of high-quality, short-term corporate bonds and GICs will continue to produce positive returns while preserving principal. Should yields rise to the upper end of our yield forecast, we may then counsel a modest increase in duration.

For further discussion, please speak to your investment advisor.