



## MONTHLY FIXED INCOME UPDATE

Hank Cunningham

July 10, 2017

Interest Rate Summary	30-Jun-17	30-Dec-16	31-Dec-15	31-Dec-14	31-Dec-13	31-Dec-12
<b>U.S.</b>						
3-Month T-Bill	1.01%	0.50%	0.16%	0.04%	0.07%	0.04%
2-Year Treasury	1.38%	1.19%	1.31%	0.47%	0.38%	0.25%
10-Year Treasury	2.31%	2.44%	2.27%	2.17%	3.03%	1.76%
<b>Canada</b>						
3-Month T-Bill	0.70%	0.45%	0.51%	0.90%	0.92%	0.92%
2-Year Canada	1.10%	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

	June 2017	Year-to-Date	2016	2015	2014	2013	2012
DEX Universe Bond Index	-1.17%	2.36%	3.52%	3.52%	8.79%	-1.19%	2.65%
DEX Federal Bond Index	-1.45%	0.85%	3.66%	3.66%	6.91%	-1.52%	2.11%
DEX Provincial Bond Index	-1.04%	3.53%	4.14%	4.14%	12.18%	-2.70%	
DEX All Corporate Index	-0.96%	2.87%	2.71%	2.71%	7.58%	0.84%	6.22%
DEX "A" Corporate Index	-0.77%	3.94%	2.62%	2.62%	9.10%	-0.16%	6.85%
DEX Real Return Bonds	-1.87%	0.07%	2.79%	2.79%	13.18%	-13.1%	
DEX High-Yield Bonds	0.46%	4.96%					

### Comments:

Performance was negative in all sectors of the bond market in June save for the High Yield sector. Corporates outperformed Governments while Real Return bonds sagged noticeably.

The U.S. ten-year note finished the month eleven basis points higher at 2.31%, after touching a low for the year at 2.12%. Since month-end, yields have continued to move up, now sitting at 2.38%. The yield on the two-year note rose by a mere ten basis points, contributing to a steepening of the yield curve, ending the recent trend towards a flatter curve.

Canada experienced a sharper increase in bond yields. Five-year Canadas rose by over fifty basis points and now sit at 1.47%, while ten-year yields rose by thirty-four basis points for the month and have tacked on an additional twelve basis points since month-end.

What happened?

After a continuation of the recent trends of average economic data and tepid inflation, four major central banks - the Federal Reserve, the Bank of England, the Bank of Canada and, most importantly, the European Central Bank - moved to hawkish positions.

Bond markets turned on remarks made by ECB head, Mario Draghi: "All the signs now point to a strengthening and broad recovery in the euro area. Deflationary forces have been replaced by reflationary ones."

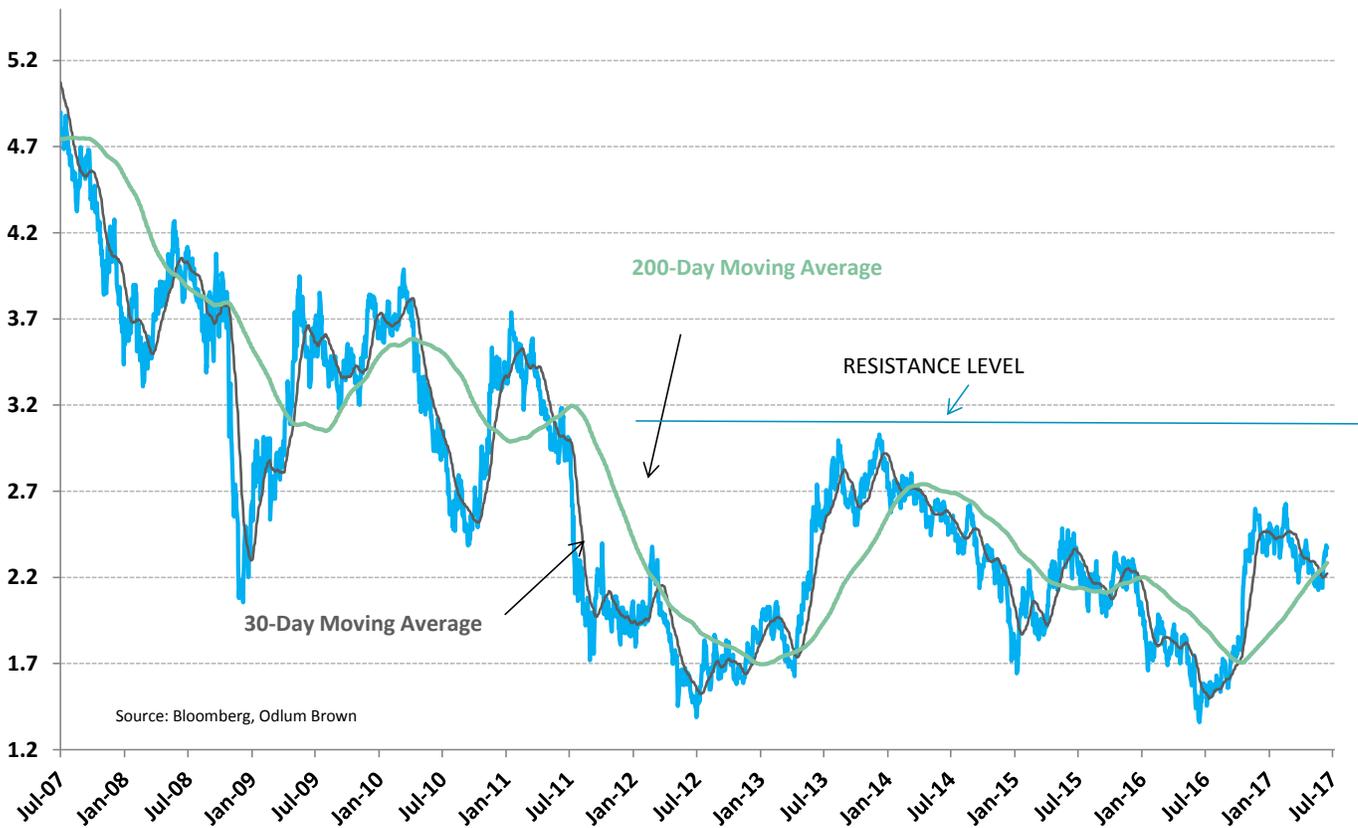
The Bank of Canada left little doubt that it would begin to normalize its overnight rate after seven years of leaving it at 0.5%.

From that point on, the Canadian economy reeled off a series of positive releases in employment, retail sales and manufacturing sales. The data was sufficiently encouraging for the Canadian GDP consensus to rise to 2.8% for 2017. Canadian bond yields rose sharply and the Loonie continued to gain ground.

As to the Federal Reserve, its rhetoric has remained on the hawkish side and, additionally, it outlined specific first steps to begin unwinding its balance sheet.

### U.S. 10-Year Treasury

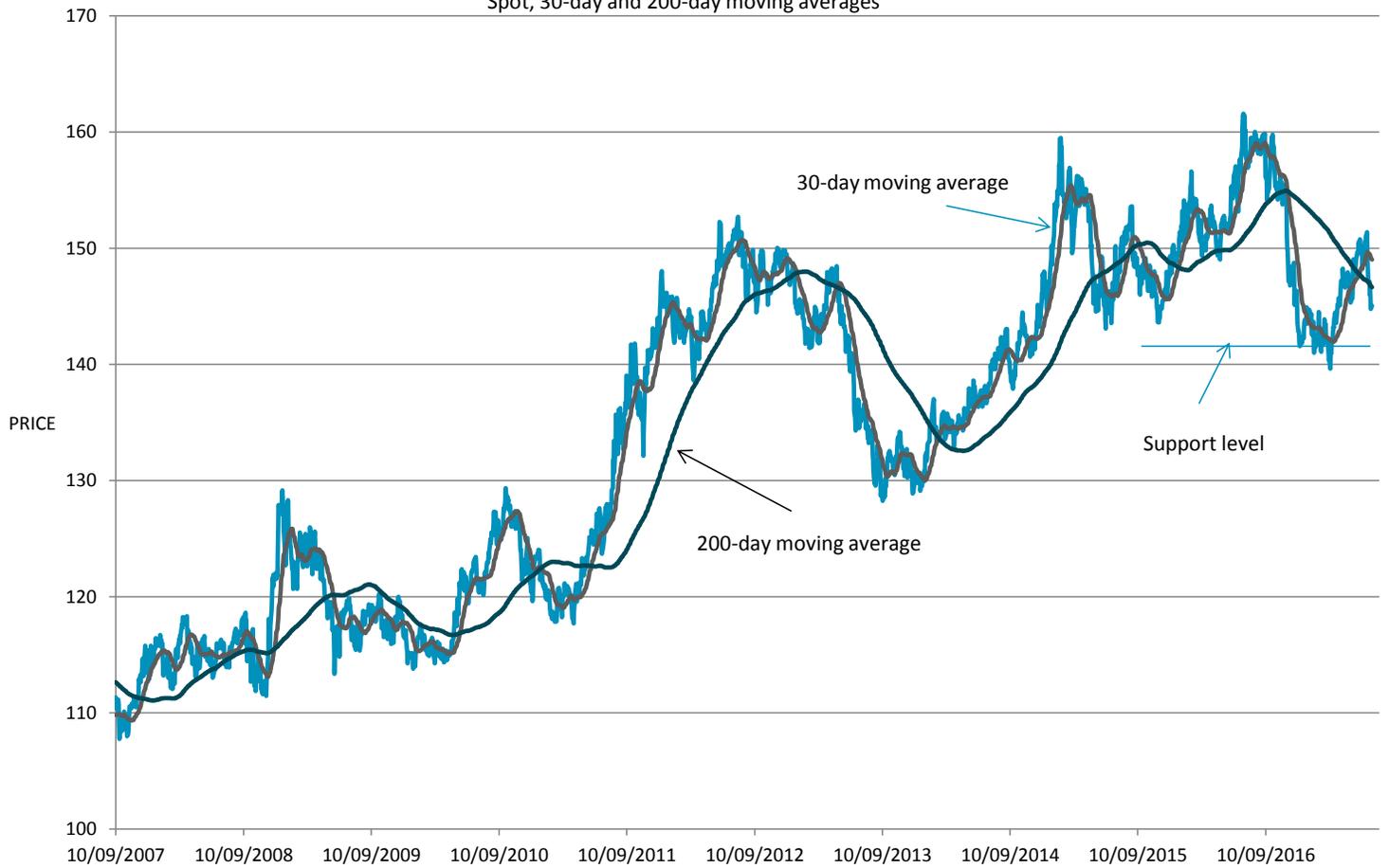
Yield (%)



This chart displays the trend of the U.S. ten-year bond yield. It has bounced off the low of the year of 2.12% and appears set to move higher in yield.

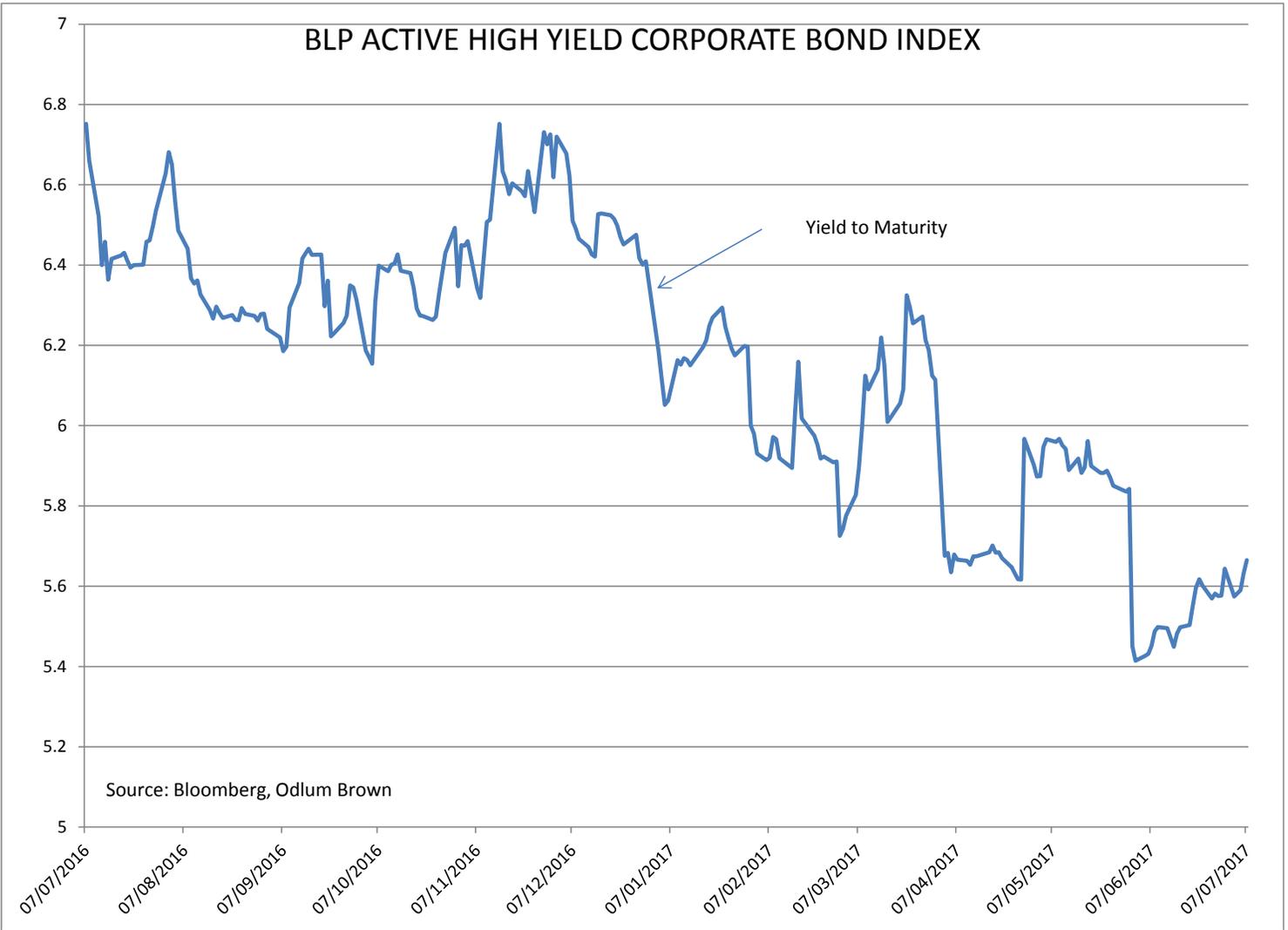
## Canada 5% June 1, 2037

Spot, 30-day and 200-day moving averages

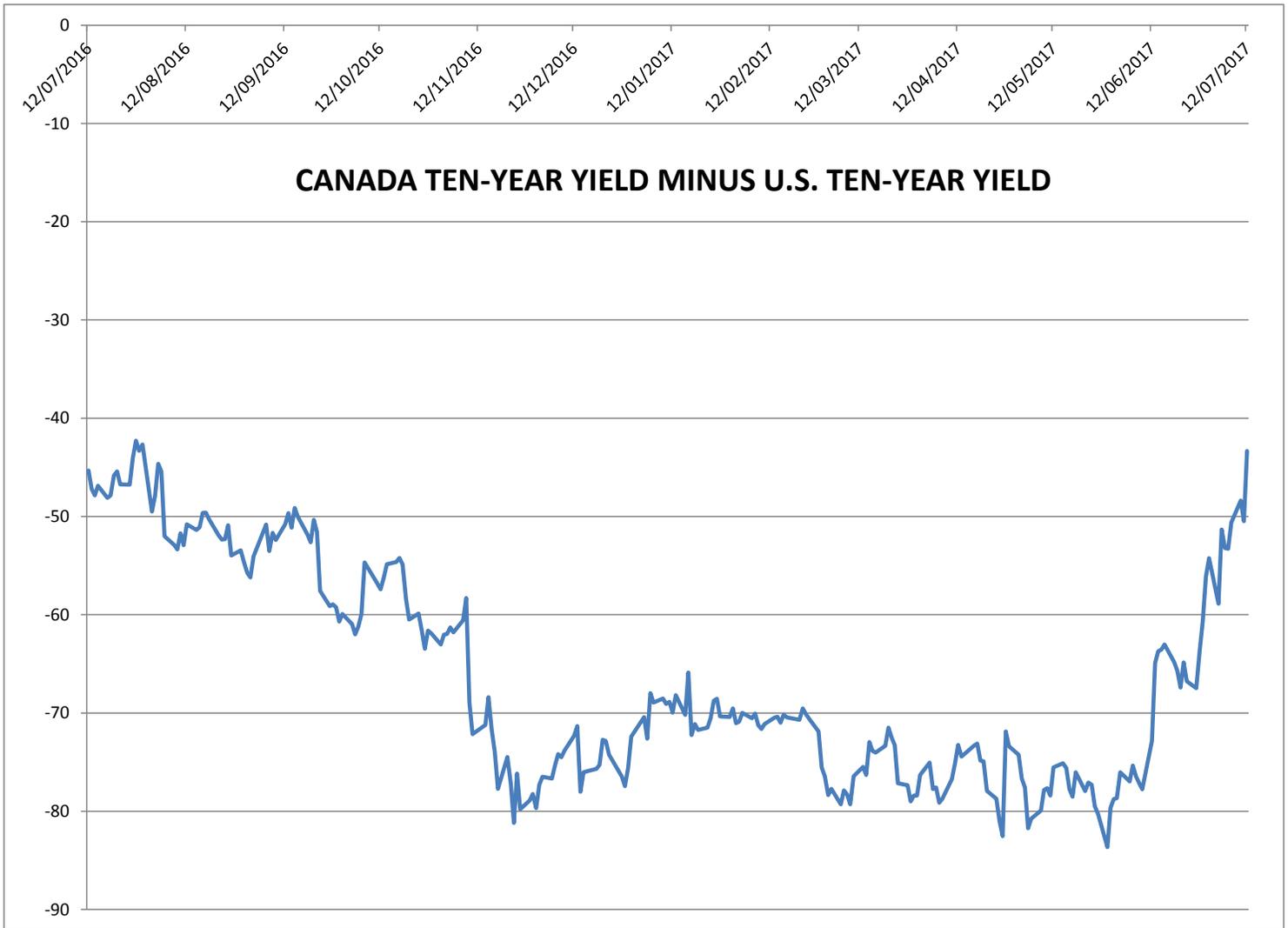


Source: Bloomberg, Odium Brown

**The price of this long-term Canada bond has fallen sharply after an impressive rebound from long-term support.**



**High-yield bond yields have also moved up sharply from their lows of the year.**



**This chart displays the dramatic narrowing of the yield between the ten-year U.S. and Canadian bonds. It underscores how weak the Canadian bond market has been in the recent past.**

## Outlook

Bond yields rose sharply from their lows of the year in June. The Fed did raise the Fed Funds Rate again and also spelled out its initial approach to unwinding its balance sheet, although it left the timing open.

Other Central Banks are getting in the mix, as the ECB may be about to remove some stimulus, while the Bank of Canada has all but affirmed that it will raise its overnight rate this week.

Collectively, the Central Banks believe that the current lack of acceleration in inflation is transitory and that it will firm-up along with wages.

The closely watched U.S. ten-year note may test its resistance level of 2.60% over the next couple of months. Corporate bond yields, both investment-grade and high-yield, will track higher with government yields.

## Strategy

We see little reason to alter the strategy of maintaining a high-quality fixed income portfolio with a relatively short duration. Where possible and practical, we favour upgrading the quality of portfolios as there are some danger signals emerging in credit markets. High-yield bonds have begun to move higher and are likely to offer average returns for the balance of the year.

---

Please read our Odlum Brown Limited Disclaimer and Disclosure - It is important!

Odlum Brown Limited is an independent, full-service investment firm focused on providing professional investment advice and objective research. We respect your right to be informed of relationships with the issuers or strategies referred to in this report which might reasonably be expected to indicate potential conflicts of interest with respect to the securities or any investment strategies discussed or recommended in this report. We do not act as a market maker in any securities and do not provide investment banking or advisory services to, or hold positions in, the issuers covered by our research. Analysts and their associates may, from time to time, hold securities of issuers discussed or recommended in this report because they personally have the conviction to follow their own research, but we have implemented internal policies that impose restrictions on when and how an Analyst may buy or sell securities they cover and any such interest will be disclosed in our report in accordance with regulatory policy. Our Analysts receive no direct compensation based on revenue from investment banking services. We describe our research policies in greater detail, including a description of our rating system and how we disseminate our research, on the Odlum Brown Limited website [www.odlumbrown.com](http://www.odlumbrown.com).

This report has been prepared by Odlum Brown Limited and is intended only for persons resident and located in all the provinces and territories of Canada, where Odlum Brown Limited's services and products may lawfully be offered for sale, and therein only to clients of Odlum Brown Limited. This report is not intended for distribution to, or use by, any person or entity in any jurisdiction or country including the United States, where such distribution or use would be contrary to law or regulation or which would subject Odlum Brown Limited to any registration requirement within such jurisdiction or country. As no regard has been made as to the specific investment objectives, financial situation, and other particular circumstances of any person who may receive this report, clients should seek the advice of a registered investment advisor and other professional advisors, as applicable, regarding the appropriateness of investing in any securities or any investment strategies discussed or recommended in this report.

This report is for information purposes only and is neither a solicitation for the purchase of securities nor an offer of securities. The information contained in this report has been compiled from sources we believe to be reliable, however, we make no guarantee, representation or warranty, expressed or implied, as to such information's accuracy or completeness. All opinions and estimates contained in this report, whether or not our own, are based on assumptions we believe to be reasonable as of the date of the report and are subject to change without notice.

Please note that, as at the date of this report, the Research Analyst responsible for the recommendations herein, associates of such Analyst and/or other individuals directly involved in the preparation of this report hold securities of the issuer(s) referred to directly or through derivatives.

No part of this publication may be reproduced without the express written consent of Odlum Brown Limited. Odlum Brown Limited is a Member of the Canadian Investor Protection Fund.

---