



MONTHLY FIXED INCOME UPDATE

Hank Cunningham

July 9, 2018

Interest Rate Summary	Jun-29-18	29-Dec-17	30-Dec-16	31-Dec-15	31-Dec-14	31-Dec-13	31-Dec-12
U.S.							
3-Month T-Bill	1.92%	1.38%	0.50%	0.16%	0.04%	0.07%	0.04%
2-Year Treasury	2.53%	1.89%	1.19%	1.31%	0.47%	0.38%	0.25%
10-Year Treasury	2.86%	2.41%	2.44%	2.27%	2.17%	3.03%	1.76%
Canada							
3-Month T-Bill	1.26%	1.05%	0.45%	0.51%	0.90%	0.92%	0.92%
2-Year Canada	1.91%	1.69%	0.74%	0.48%	0.99%	1.14%	1.14%
10-Year Canada	2.17%	2.04%	1.72%	1.39%	1.86%	2.76%	1.80%

Performance

	Jun-2018	2017	2016	2015	2014	2013	2012
DEX Universe Bond Index	0.57%	2.52%	3.52%	3.52%	8.79%	-1.19%	2.65%
DEX Federal Bond Index	0.46%	0.13%	3.66%	3.66%	6.91%	-1.52%	2.11%
DEX Provincial Bond Index	0.82%	4.33%	4.14%	4.14%	12.18%	-2.70%	
DEX All Corporate Index	0.41%	3.38%	2.71%	2.71%	7.58%	0.84%	6.22%
DEX "A" Corporate Index	0.42%	4.42%	2.62%	2.62%	9.10%	-0.16%	6.85%
DEX Real Return Bonds	1.09%	0.72%	2.79%	2.79%	13.18%	-13.1%	
DEX High Yield Bonds	0.75%	5.20%	13.79%	-5.58%	2.64%	6.87%	

Provincial bonds outperformed investment-grade corporate bonds by a wide margin again. The high yield market also returned positive results.

The U.S. yield curve flattened by ten basis points as the two-year yield rose while the ten-year yield was unchanged. The Canadian yield curve flattened by six basis points.

Comments

June saw a pickup in inflation in the U.S. as the headline rate hit a six-year high of 2.8% with other inflation measures also increasing. The month began and ended with strong employment reports in the U.S.; a host of solid economic data was released in between, such as housing, industrial production, consumer confidence and retail sales.

The Federal Reserve Board raised the Fed Funds Rate a further 25 basis points and issued an upbeat forecast for the economy, paving the way for two more hikes this year.

On the surface, one would have expected bond yields to rise but the closely watched ten-year note was unchanged at 2.86%. A couple of items contributed to this: (1) non-energy inflation fell. Copper for example, is down 14% for the year-to-date; and (2) wage growth remained sluggish.

Canada's experience was different. The month began with wage growth hitting 3.9%, followed by a series of weak data, including employment, housing and retail sales. Bond yields fell. The loonie slumped as the market anticipated the Bank of Canada would hold the line on the Bank Rate. As the month progressed, prospects improved with a surprisingly good GDP print, improving trade results and a good employment report. The odds are that the Bank of Canada will raise rates this week.

Elsewhere, the European Central Bank spelled out its tapering plans, with quantitative easing to be phased out by year-end.

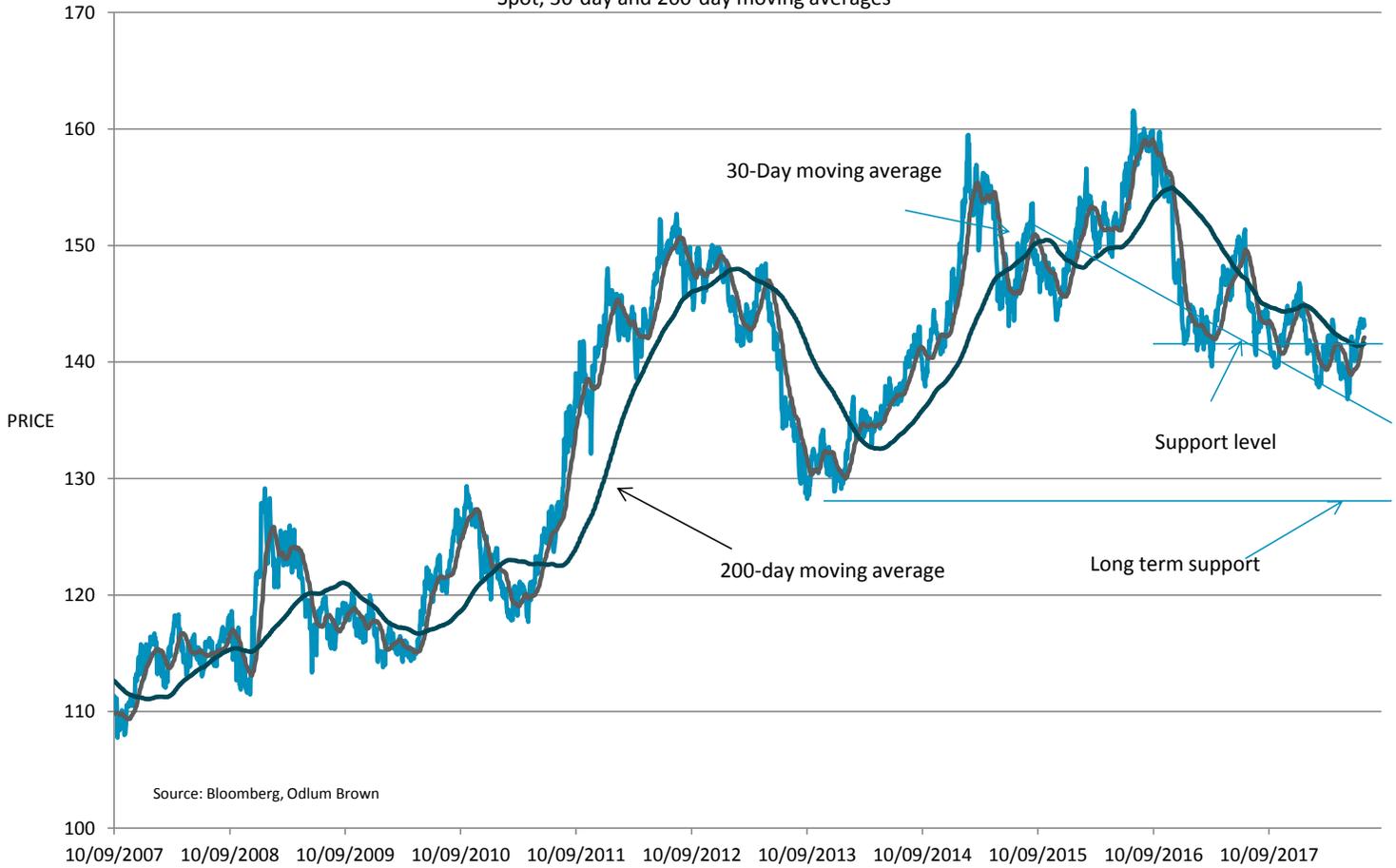
U.S. 10-Year Treasury



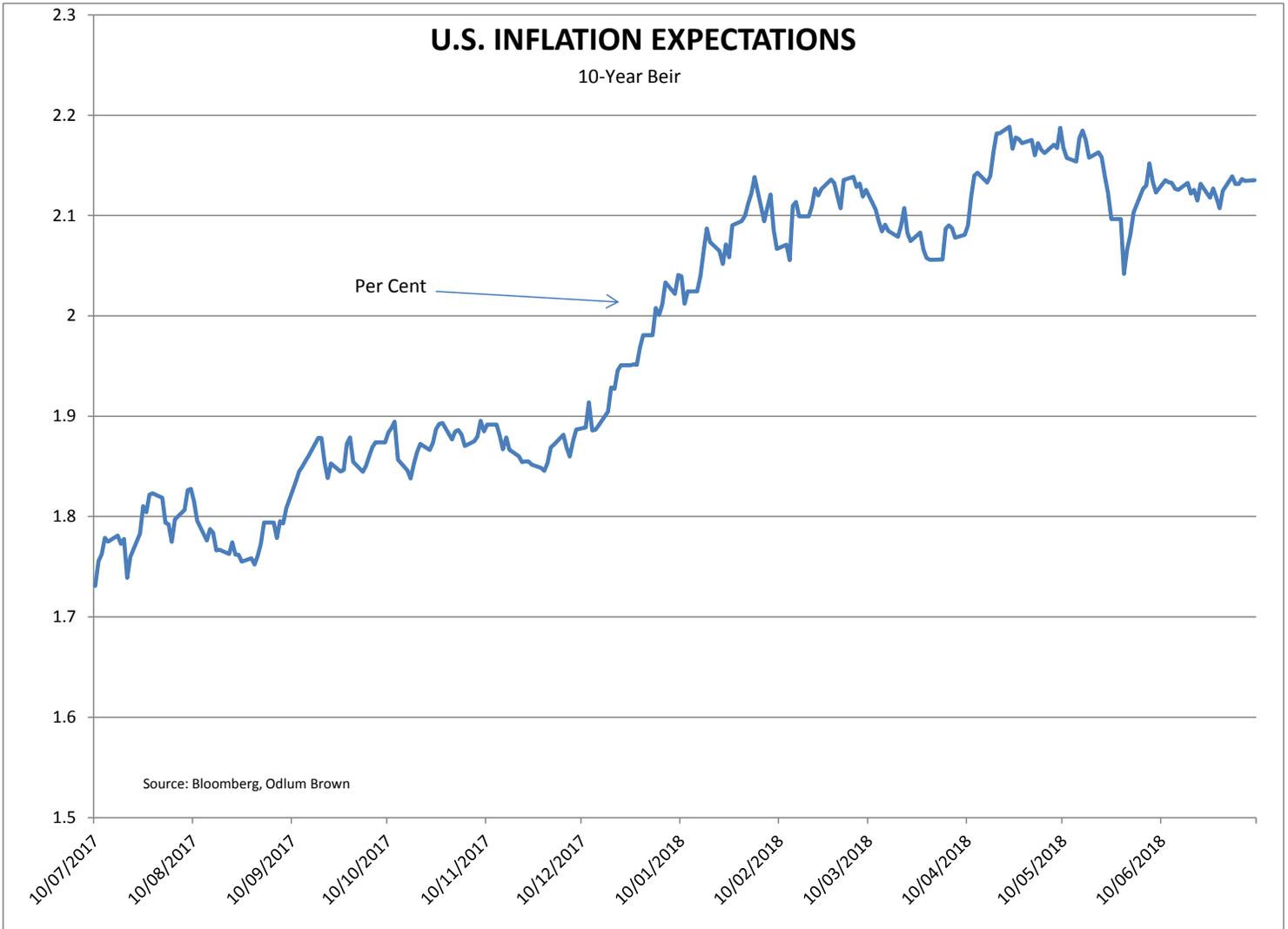
The yield on this bellwether bond is fluctuating between 2.80% and 3%.

Canada 5% June 1, 2037

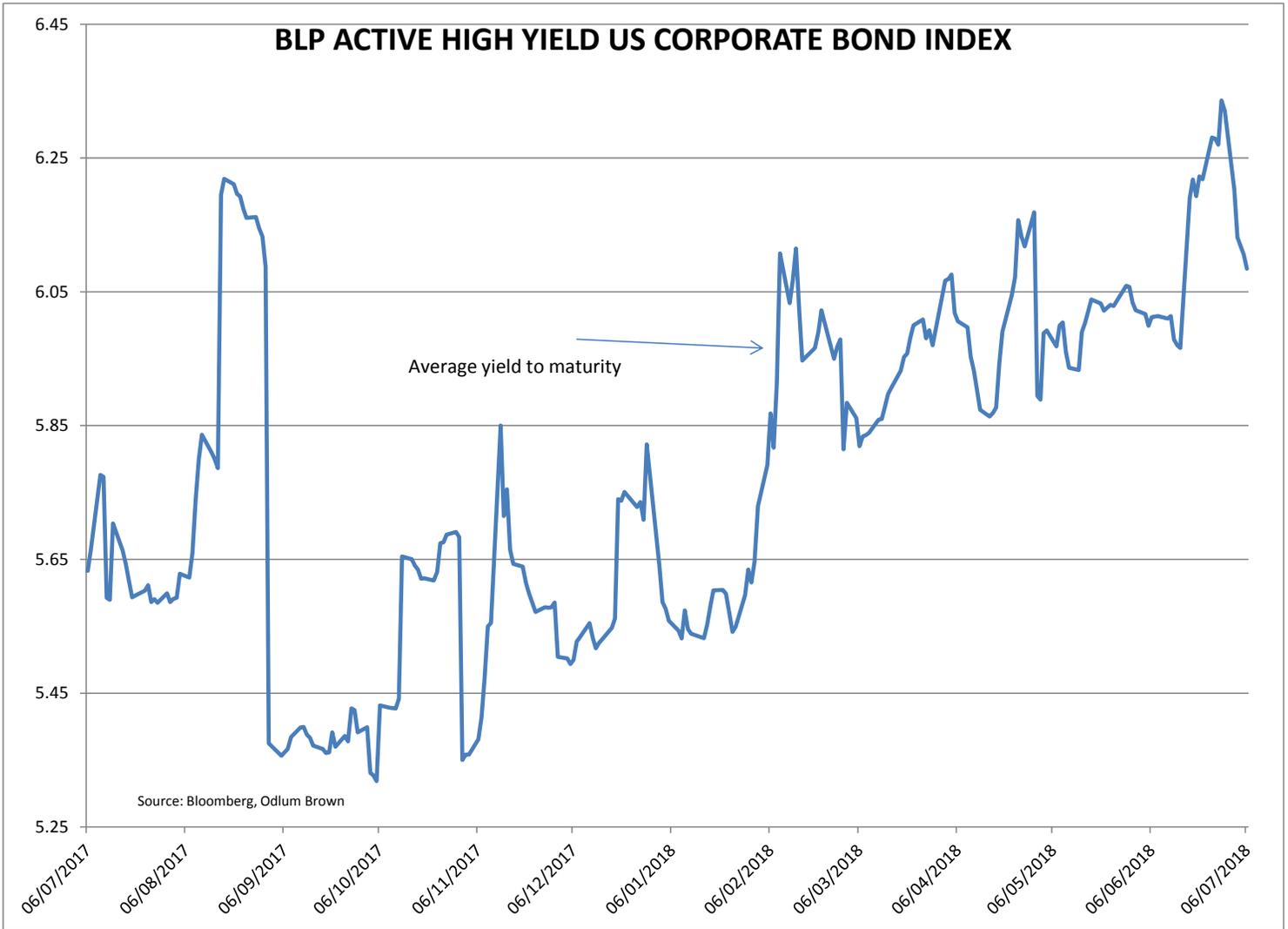
Spot, 30-day and 200-day moving averages



The price of this long-term Canada bond rallied further in the past month, moving above all the moving averages with positive momentum.



After recent increases, inflation expectations have stabilized.



The high yield market has been volatile in the past three months but has settled down lately.

Outlook

Given the strong fundamentals for the U.S. economy and the accompanying rise in inflation, ten-year yields should move above 3% soon, with a year-end target of 3.25% a distinct possibility.

The Federal Reserve and the Bank of Canada will continue to withdraw accommodation at a measured pace and thus will move their respective key short-term rates ever closer to “normal.”

Overhanging the bond market is the possible detriment to global growth arising from the tussle over tariffs. Neither the Fed nor the Bank of Canada has made any downgrades thus far to their respective forecasts.

Credit markets have displayed some nervousness understandably but, overall, they remain well-behaved.

Strategy

Against this backdrop, it is difficult to foresee anything but modest or negative returns in fixed income portfolios. The preservation of capital should be the main theme for fixed income investors. 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, as even with the expected rise in government yields, their total returns should still exceed returns from the government sector. We also favour floating rate bonds, which stand to benefit from increases in administrative rates by the Fed and the Bank of Canada.

At present, the credit markets are showing only modest signs of strain and yield spreads remain relatively narrow. Should we perceive significant weakness in credit markets, we may advise including selected provincial bonds in clients’ portfolios. There is a case to be made for 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.

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

Odium 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 Odium Brown Limited website www.odiumbrown.com.

This report has been prepared by Odium Brown Limited and is intended only for persons resident and located in all the provinces and territories of Canada, where Odium Brown Limited's services and products may lawfully be offered for sale, and therein only to clients of Odium 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 Odium 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 Odium Brown Limited. Odium Brown Limited is a Member of the Canadian Investor Protection Fund.
