



MONTHLY FIXED INCOME UPDATE

Hank Cunningham

March 10, 2017

Interest Rate Summary	28-Feb-17	30-Dec-16	31-Dec-15	31-Dec-14	31-Dec-13	31-Dec-12
U.S.						
3-Month T-Bill	0.61%	0.50%	0.16%	0.04%	0.07%	0.04%
2-Year Treasury	1.26%	1.19%	1.31%	0.47%	0.38%	0.25%
10-Year Treasury	2.39%	2.44%	2.27%	2.17%	3.03%	1.76%
Canada						
3-Month T-Bill	0.50%	0.45%	0.51%	0.90%	0.92%	0.92%
2-Year Canada	0.76%	0.74%	0.48%	0.99%	1.14%	1.14%
10-Year Canada	1.63%	1.72%	1.39%	1.86%	2.76%	1.80%

Performance

	Feb-2017	Year-to-Date	2016	2015	2014	2013	2012
DEX Universe Bond Index	0.96%	0.83%	3.52%	3.52%	8.79%	-1.19%	2.65%
DEX Federal Bond Index	0.59%	0.45%	3.66%	3.66%	6.91%	-1.52%	2.111%
DEX Provincial Bond Index	1.30%	0.77%	4.14%	4.14%	12.18%	-2.70%	
DEX All Corporate Index	0.99%	1.40%	2.71%	2.71%	7.58%	0.84%	6.22%
DEX "A" Corporate Index	1.20%	1.42%	2.62%	2.62%	9.10%	-0.16%	6.85%
DEX Real Return Bonds	0.82%	-1.09%	2.79%	2.79%	13.18%	-13.1%	
DEX High Yield Bonds	0.99%	3.14%					

Comments:

Performance was positive in all sectors of the bond market in February. Investment-grade and high-yield corporate bonds continued to outperform governments.

The U.S. ten-year note finished the month five basis points lower at 2.39% after dropping to as low as 2.32%.

While the month began with a solid increase of 227,000 non-farm jobs in the U.S., the bond market focused on the dip in wage growth. The Fed chipped in with a bland, non-hawkish statement.

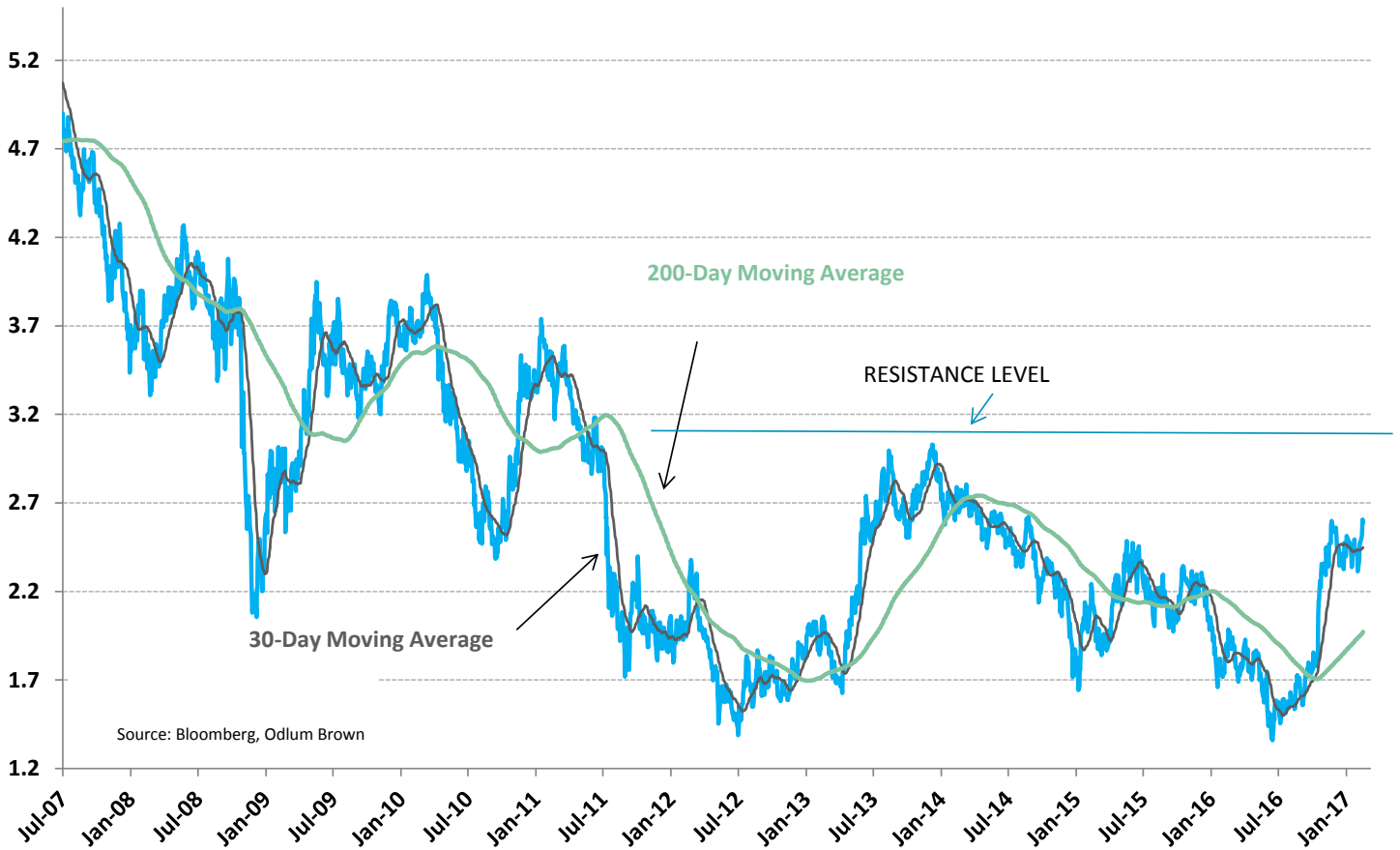
The bloom came off the Trump reflation trade as the reality is setting in that any of his pro-growth policies will take time to implement and add only marginally to GDP this year.

In mid-month, Fed Chair Yellen offered more upbeat testimony to Senate and Congress, suddenly moving the odds higher for an increase in the Fed Funds Rate in March. These odds moved close to 100% as the month wore on and key components of growth, namely consumer spending and sentiment, the housing market, and business spending, continued to exhibit momentum. The latest employment report in early March, exceeded consensus again, sealing the fate for the Fed Funds hike expected on March 15, 2017.

Canada's economy is matching the growth of the U.S. economy, thanks to a string of positive news in the areas of employment, merchandise trade, home and auto sales, and consumer spending and confidence. Canada's real GDP growth appears headed for a pace of 2.5%.

U.S. 10-Year Treasury

Yield (%)



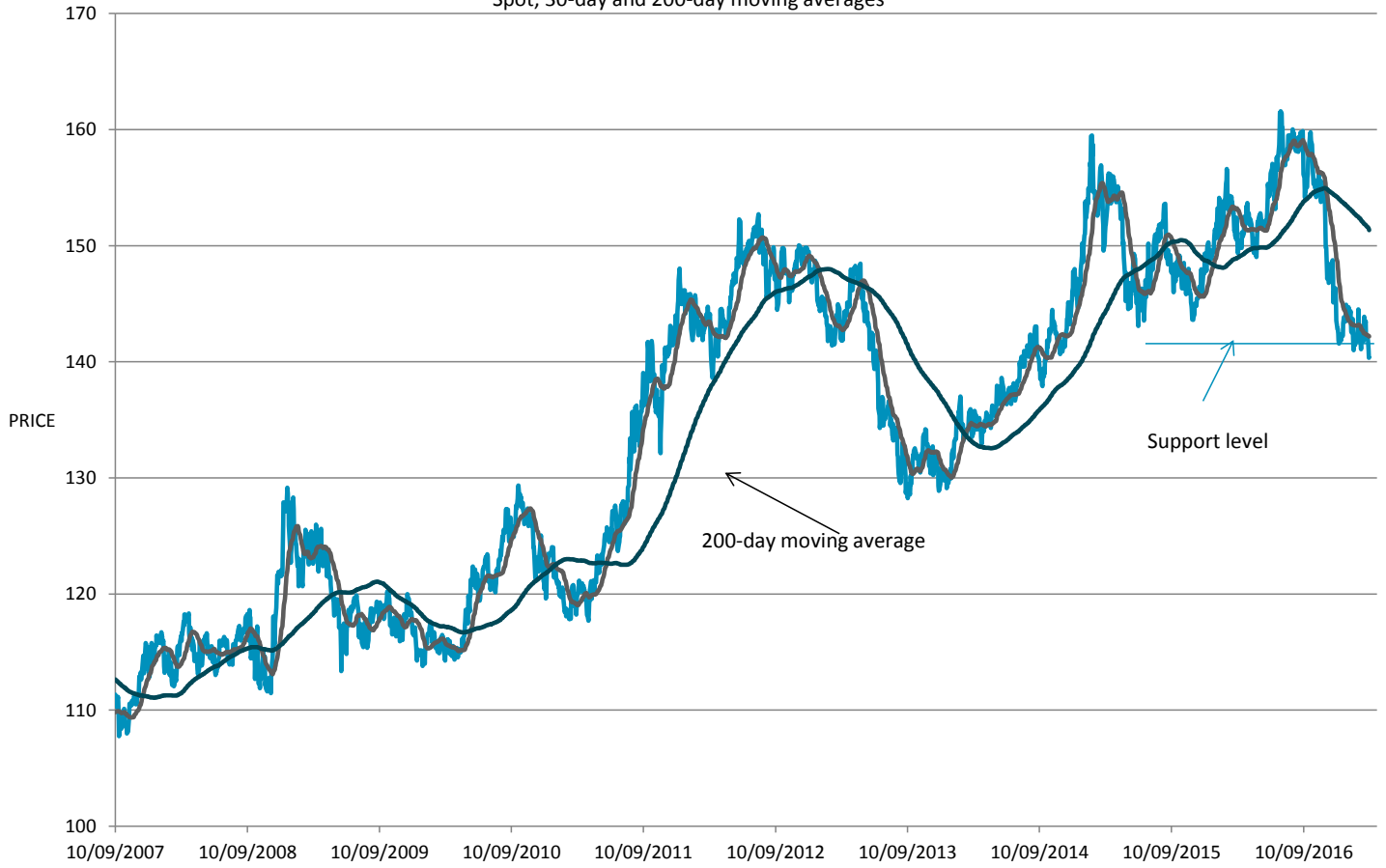
Source: Bloomberg, Odium Brown

Source: Bloomberg, Odium Brown

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%.

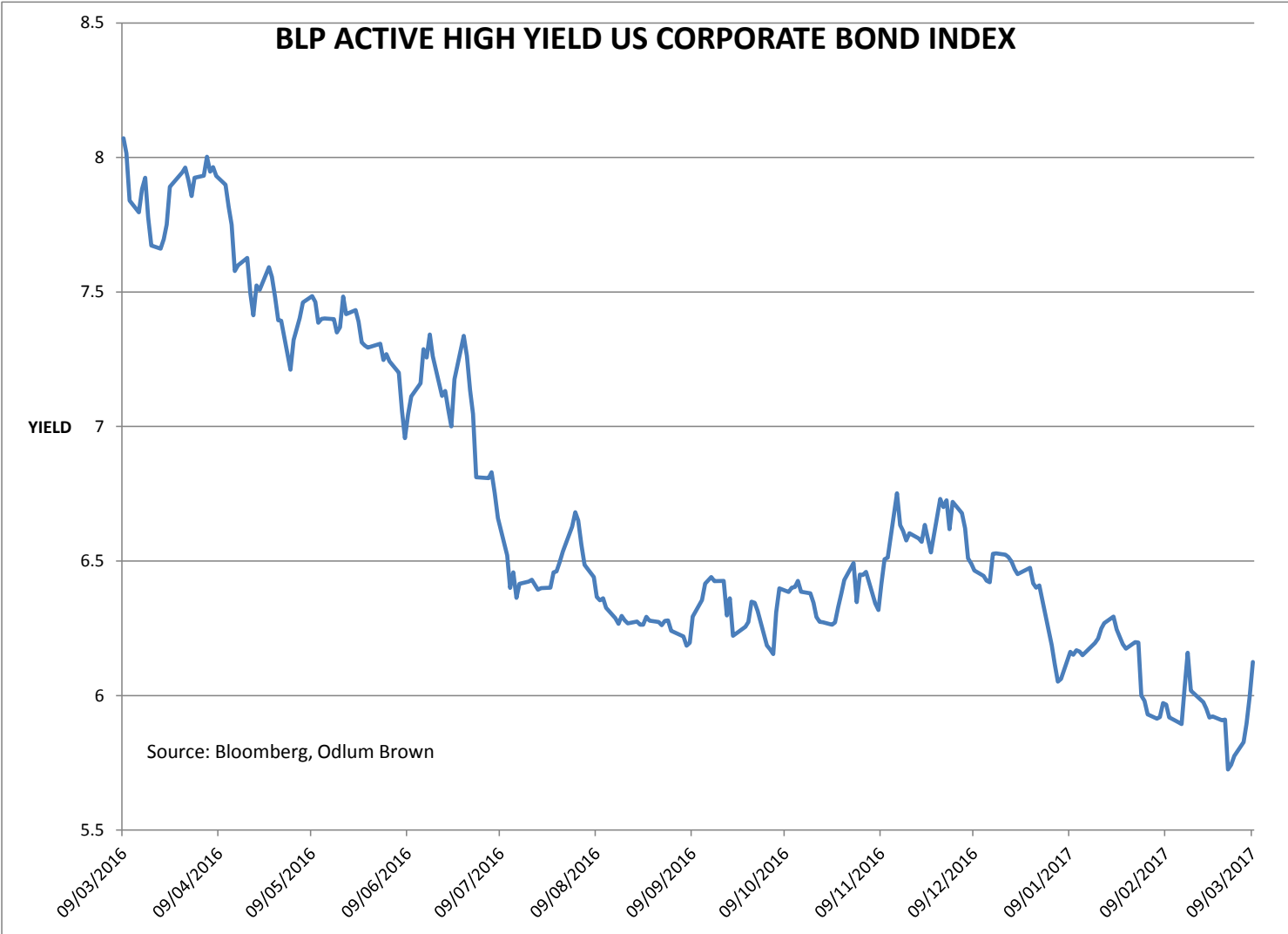
Canada 5% June 1, 2037

Spot, 30-day and 200-day moving averages



Source: Bloomberg, Odium Brown

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



High-yield bonds are rising in yield in response to rising Government yields.

Outlook

The global economy has entered a phase of synchronized, albeit weak, growth, which has yet to be accompanied by rising inflation. Now that market analysts are correctly downgrading the reflation effects of Trump's initiatives, growth estimates for the U.S. have settled into the 2.5% range.

The Federal Reserve is poised to raise the Fed Funds Rate on March 15 and perhaps three more times this year given current trends. Longer-term bond yields should continue to rise. It is possible to see some downward pressure on bond yields for the same reasons as in the recent past, namely, demographics, the debt overhang and weak growth and inflation. However, we feel that the odds favour the ten-year U.S. Treasury note reaching 3% this year as the employment market tightens further and as wage inflation exhibits some upside.

The Canadian economy is also forecast to grow at 2.5% in 2017. The Bank of Canada has remained dovish thus far, but as both short-term and long-term U.S. yields continue to rise, our yields will be dragged higher and the Bank of Canada will have to move away from its accommodative stance.

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.

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 at 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 some 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.
