



MONTHLY FIXED INCOME UPDATE

Hank Cunningham

March 11, 2019

Interest Rate Summary	Feb-28-19	Dec-31-18	29-Dec-17	30-Dec-16	31-Dec-15	31-Dec-14	31-Dec-13
U.S.							
3-Month T-Bill	2.44%	2.36%	1.38%	0.50%	0.16%	0.04%	0.07%
2-Year Treasury	2.52%	2.49%	1.89%	1.19%	1.31%	0.47%	0.38%
10-Year Treasury	2.72%	2.69%	2.41%	2.44%	2.27%	2.17%	3.03%
Canada							
3-Month T-Bill	1.67%	1.64%	1.05%	0.45%	0.51%	0.90%	0.92%
2-Year Canada	1.78%	1.86%	1.69%	0.74%	0.48%	0.99%	1.14%
10-Year Canada	1.94%	1.97%	2.04%	1.72%	1.39%	1.86%	2.76%

Performance

	Feb 2019	2018	2017	2016	2015	2014	2013
DEX Universe Bond Index	0.18%	1.41%	2.52%	3.52%	3.52%	8.79%	-1.19%
DEX Federal Bond Index	-0.05%	2.39%	0.13%	3.66%	3.66%	6.91%	-1.52%
DEX Provincial Bond Index	0.31%	0.66%	4.33%	4.14%	4.14%	12.18%	-2.70%
DEX All Corporate Index	0.31%	1.10%	3.38%	2.71%	2.71%	7.58%	0.84%
DEX "A" Corporate Index	0.13%	0.51%	4.42%	2.62%	2.62%	9.10%	-0.16%
DEX Real Return Bonds	-0.28%	-0.05%	0.72%	2.79%	2.79%	13.18%	-13.1%
DEX High Yield Bonds	1.57%	2.15%	5.20%	13.79%	-5.58%	2.64%	6.87%

Corporate bonds continued their positive performance in February and high yield bonds improved further, making them the top performers in fixed income markets so far this year.

Comments

While U.S. Treasury yields, measured by the bellwether ten-year, rose by three basis points for the month, this masked what happened globally. The apparent soft economic patch extended to the point that every central bank in the developed world stopped tightening and, in the case of the ECB, introduced a measure of easing. German ten-year bund yields fell to a mere 5 basis points!

The global economic weakness occurred in the areas of: production, consumer confidence, retail sales and PMIs.

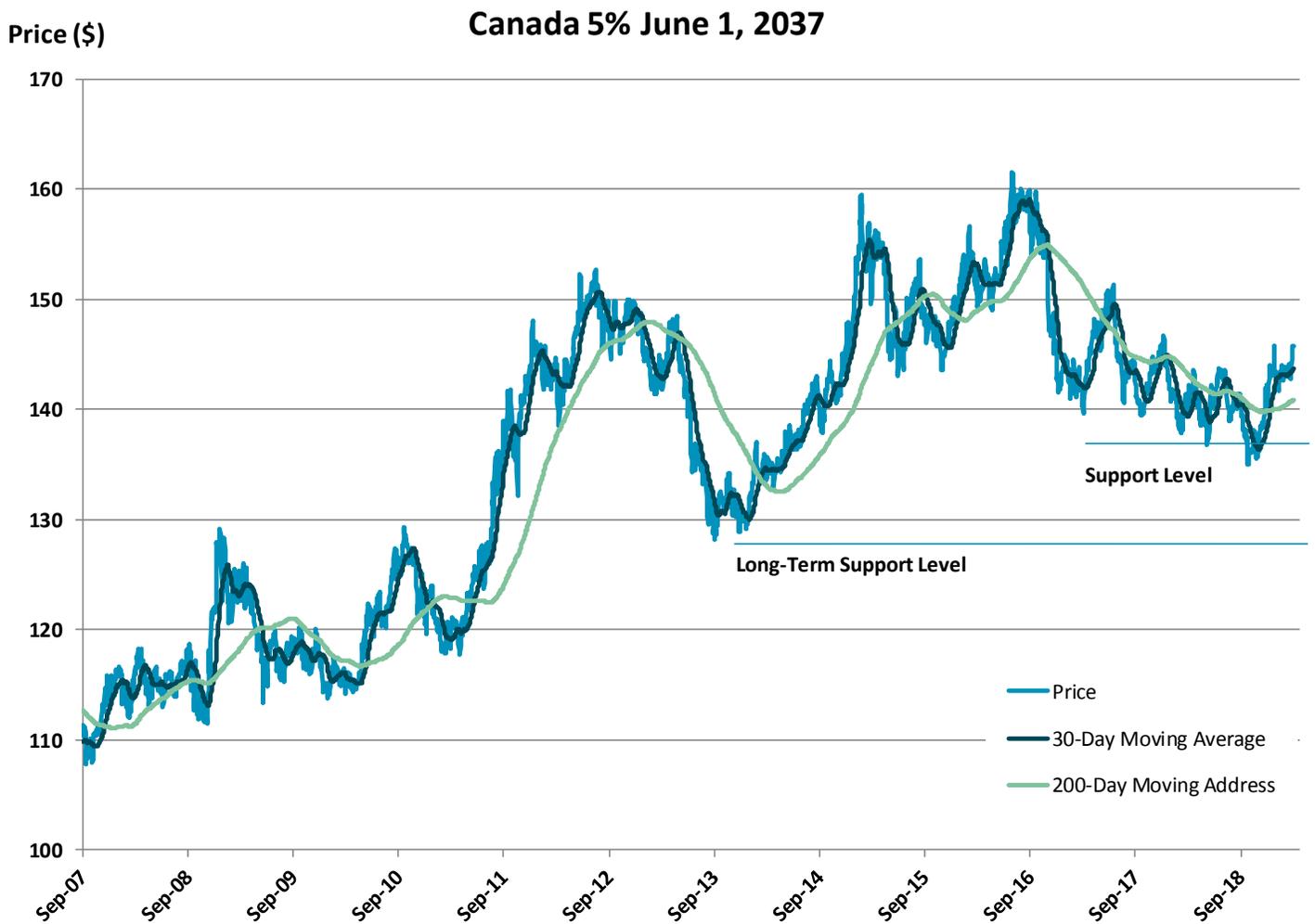
In the U.S. specifically, retail sales and consumer confidence, along with home sales and manufacturing, waned noticeably.

Canada was no exception, with the Bank of Canada's sharp downward revision in 2019 GDP estimates from 1.7% to 1.1%. The Bank of Canada stated clearly that it would be on the sidelines indefinitely. As a result, Canadian ten-year bond yields fell to 1.8%, 87 basis points lower than their U.S. equivalent, the most negative since 2015.

Another development was a modest steepening of the U.S. yield curve as the Federal Reserve moved to the sidelines and there was a modest uptick in inflation. The yield spread between two- and ten-year treasuries widened by 10 basis points to a still modest 20 basis points. More telling is the spread between 10- and 30-year U.S. bonds; it widened to 40 basis points from 15 basis points in September, 2018.

The ECB announced that it would leave its key lending rate unchanged all year and introduced one easing method.

The loonie, after performing well this year, fell 2.4% for the month on both economic softness and political overtones.



The price of this long-term Canada bond rebounded from its support levels and moved above all its moving averages. Momentum has swung to positive.

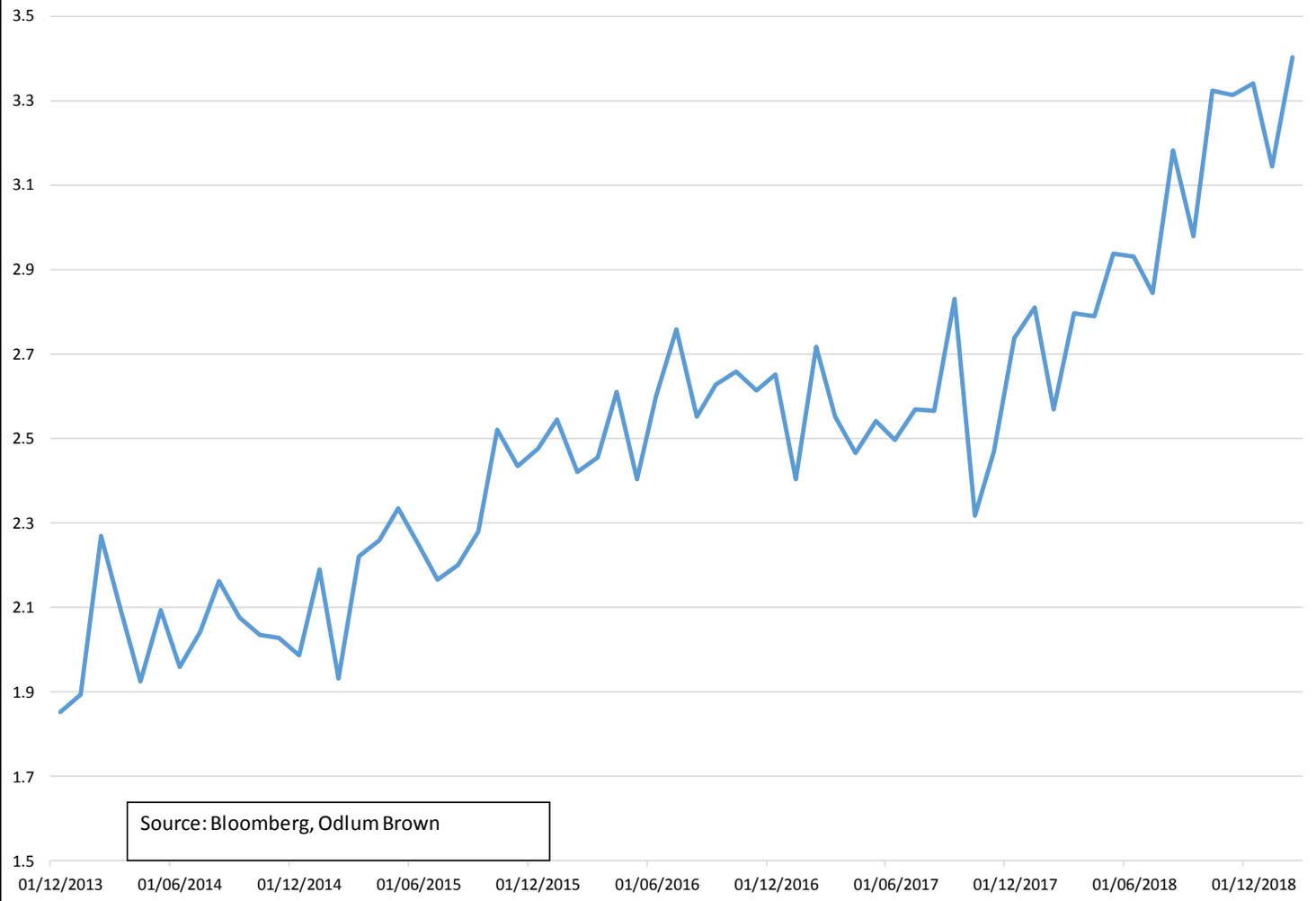
U.S. 10-Year Treasury



Source: Bloomberg, Odium Brown

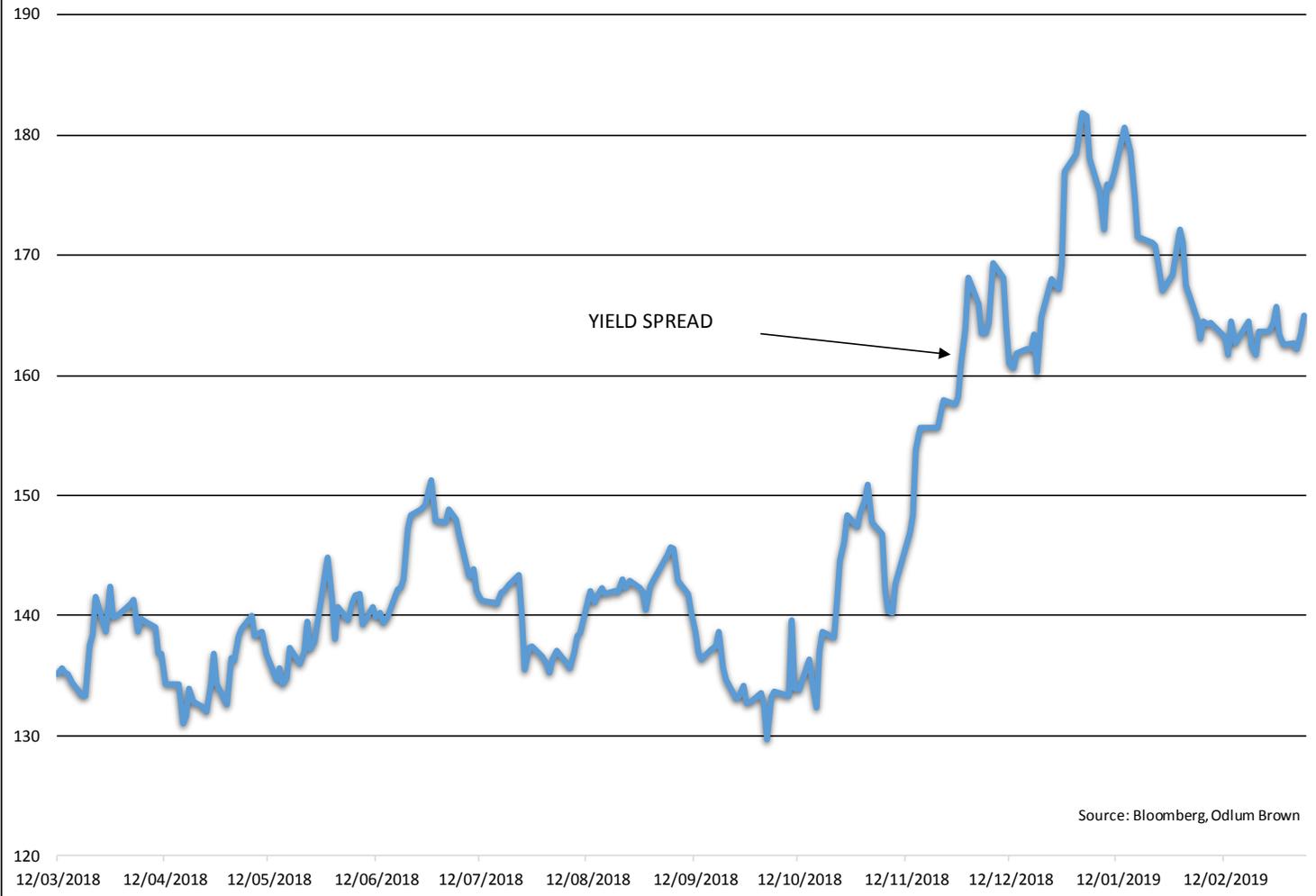
This global bellwether bond is locked in a narrow trading range with low volatility.

U.S. AVERAGE HOURLY EARNINGS ANNUAL PERCENT CHANGE



Wage growth accelerated, reflecting the strong labour market.

U.S. TEN-YEAR VERSUS MOODY'S INVESTMENT GRADE YIELDS



The yield spread between investment grade bonds and Treasury bonds increased slightly but is stable.

Outlook

After the Federal Reserve was joined on the sidelines by central banks in Canada, Europe, Australia and China, the bond market moved to a state of equilibrium, as bond yields respond to natural market forces.

Monetary policy moved away from further tightening in response to mounting evidence of slowing global economic growth. Some pundits are calling for rate cuts by the central banks.

This recency bias ignores the fact that global growth remains positive but at a slower pace. The U.S. economy is not immune to global conditions and there has been slowing in several key sectors such as auto sales, consumer confidence and home sales. At the same time, markets are catching a whiff of inflation, which has resulted in a steepening of the yield curve, particularly in the widening spread between 10- and 30-year Treasuries. The 30-year bond yield has added 15 basis points since the beginning of the year. Inflation expectations snapped back to near 2% on a 6% increase in commodity prices and wage gains.

There is little stress in the investment grade and high yield markets.

Meanwhile, global bond yields fell sharply. The German ten-year bund sunk to a mere 5 basis points! Thus, the U.S. bond market remains the high-yielding beacon among global bond markets and continues to attract international investors, especially given the strong dollar. Against this tug-of-war, U.S. ten-year bond yields could fall to 2.50%. The Fed is willing to tolerate inflation running above its 2% target, so if inflation does pick up further, upward bias would then return to bond yields, perhaps pushing them to 3%.

Canada experienced a dramatic slowing in GDP in Q4, with weakness in trade and retail sales evident. The Bank of Canada moved to the sidelines and, in a dovish announcement, pared its growth estimates considerably, leaving little doubt that it will remain on the sidelines indefinitely. Thus, Canadian fixed income investors are facing a period of flat to declining yields.

Strategy

We continue to stress investment in high-quality, short-duration corporate bonds. We favour the one- to five-year laddered approach. As for the high yield market, conditions have improved and investors may consider investing 5% to 10% of their fixed income portfolios in this sector, preferably through ETFs. Also, investors may consider using one of our selected outside fixed income managers.

For further discussion, please speak to your investment 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.

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 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 Odium Brown Limited. Odium Brown Limited is a Member of the Canadian Investor Protection Fund.
